Cartels

What is a Cartel

• A Cartel is an organization by firms to set output and prices.

Why a Cartel

• A Cartel is an organization by firms to set output and prices.
• If the firms can agree to reduce output and are successful in excluding competitors, they can increase total industry profits.

Difficulties

• A Cartel is an organization by firms to set output and prices.
• If the firms can agree to reduce output and are successful in excluding competitors, they can increase total industry profits.
• The problems are obvious.
  – Firms want to cheat
  – Firms want to enter.

The Graph

A firm in competitive equilibrium.

Industry Equilibrium

Here is the market condition.
If the firms collude to cut output, price and profits will rise.

But if the firm cheats it will do even better!

Firms have an incentive to cheat on the cartel agreement.

Further, since p is high, other firms have an incentive to enter the business.

Anti-Trust Law

- Cartels are *per se* violations of the Sherman Act.
**Anti-Trust Law**

- Cartels are *per se* violations of the Sherman Act.
- You cannot enter into written contracts to enforce a cartel.

**Smith and Wilson**

- Smith Hardware and Wilson Hardware agree to form a cartel.

**No Honor Among Thieves**

- Smith Hardware and Wilson Hardware agree to form a cartel.
- Each one still has the incentive to cheat.

**Anti-Trust Law**

- Smith Hardware and Wilson Hardware agree to form a cartel.
- Each one still has the incentive to cheat.
  - Without a written agreement, how do you tell if cheating is an honest misunderstanding or deliberate cheating?

**Entry**

- Smith Hardware and Wilson Hardware agree to form a cartel.
- Each one still has the incentive to cheat.
- And how do you prevent Home Depot from opening?
The Cali Cartel

• Drug Cartels are well known
• They solve the problem of cheating with violence.

End

©2005 Charles W. Upton