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The Initiation of Privatization, Market Structure, and Free Entry with Vertically Related Markets

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Abstract : The existing literature provides little discussion on why a public monopolist gives up its market dominant position and allows private firms entering the market. We argue that the privatization of a public monopolist under a vertically related market may induce the entry of private firms. We develop a model of a mixed oligopoly with vertically related markets to explain the change in the market from a public monopolist to a mixed oligopoly and examine issues on privatizing the downstream public enterprise both in the short run and long run in the vertically related markets. We first show that the welfare-maximizing public monopoly firm is suboptimal in the vertically related markets. This is due to the fact that the privatization will reduce the input price charged by the upstream foreign monopolist. Further, the privatization will induce the entry of private firms since input price will decrease after privatization. Third, we demonstrate that the complete privatizing the public firm becomes a possible solution if the entry cost of private firm is low. Finally, we indicate that the public firm should partially privatize if the free-entry of private firms is allowed. JEL classification: F12, F14, L32, L33

Keywords : free entry, mixed oligopoly, public monopoly, the initiation of privatization, vertically related markets, mixed oligopoly
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