Allowing for two production periods in the Cournot duopoly
Müller, W.

Published in:
Journal of Economic Behavior and Organization

Document version:
Publisher's PDF, also known as Version of record

Publication date:
2006

Link to publication

Citation for published version (APA):
Allowing for two production periods in the Cournot duopoly: Experimental evidence

Wieland Müller *

Department of Economics, Tilburg University, P.O. Box 90153, 5000LE Tilburg, The Netherlands

Received 6 October 2003; accepted 8 June 2004
Available online 13 June 2005

Abstract

In this study behavior in a Cournot duopoly with two production periods (the market clears only after the second period) is compared to behavior in a standard one-period Cournot duopoly. Theory predicts the endogenous emergence of a Stackelberg outcome in the two-period market. The results of the experiments, however, reveal that in both markets (roughly) symmetric outcomes emerge and that, after a short adaptation phase, average industry output in the two-period markets is the same as in the standard one-period markets.

© 2005 Elsevier B.V. All rights reserved.

JEL classification: C72; C91

Keywords: Cournot duopoly; Stackelberg; Flexibility; Experiments

1. Introduction

In the standard Cournot duopoly both firms are assumed to decide only once and simultaneously about their outputs before the market clears. Saloner (1987) analyzes an extended market game allowing for two production periods before the market clears. In this model, the initial outputs chosen in the first production period become publicly known before firms decide about their additional non-negative outputs in the second production period. Only after the second production period is the market price determined according to the total

* Tel.: +31 13 466 3460; fax: +31 13 466 3460.
E-mail address: w.mueller@uvt.nl.

0167-2681/S – see front matter © 2005 Elsevier B.V. All rights reserved.
doi:10.1016/j.jebo.2004.06.025
amount of output produced in both periods. Moreover, production costs are assumed to be the same in both periods. Saloner shows that in case of constant marginal costs and linear demand\footnote{Saloner actually allows for a much more general demand function. See Section 2 and especially footnote 15.} any outcome on the outer envelope of the best-response functions between and including the firms’ Stackelberg points\footnote{This is set \( E \) indicated in Fig. 1.} can be achieved in a subgame perfect Nash equilibrium of the two-period model. However, Ellingsen (1995) shows that only the Stackelberg points survive the elimination of weakly dominated strategies. Thus, the interesting feature of this model is that it predicts an asymmetric outcome even when firms are a-priori symmetric. As a consequence total quantity and welfare are higher than in a standard one-period Cournot market.

Another model in which duopolists are given more flexibility in the timing of moves is Hamilton and Slutsky’s (1990) extended game with action commitment in which two firms may choose their action in one out of two periods. A firm may move early by committing itself to a quantity, or it may wait until the second period and observe the other firm’s first-period action. Again, there are two endogenous Stackelberg equilibria with either firm as the Stackelberg leader.\footnote{See Matsumura (1999), for a more general version of this model with more than two firms and with more than two production periods.} While there also exists a simultaneous-move Cournot equilibrium in pure strategies, this equilibrium is in weakly dominated strategies.

This paper reports the results of an experiment designed to investigate Saloner’s two-period model with quantity competition and identical firms. In the experiment, fixed pairs of subjects are repeatedly matched to play the game. The results in the two-period market are compared with results in standard one-period Cournot markets. Given the two models’ predictions, I shall focus on three research questions: (1) Do we observe the endogenous emergence of Stackelberg outcomes in the two-period markets? (2) Will the two-period markets (as in theory) yield higher total outputs at smaller prices than standard Cournot markets, thus increasing total welfare?\footnote{In Huck et al. (2001) in which Stackelberg markets with exogenous role assignment are compared with Cournot markets, it is found that although “pure” Stackelberg outcomes are rarely observed, total output in the former markets are consistently higher than in the latter.} (3) What is the actual behavior in the two periods of Saloner’s model?\footnote{A stunning failure of subjects to go through longer chains of reasonings is reported in a recent paper by Kühler and Weizsäcker (2004) on informational cascades. For further evidence on subjects’ depth of reasoning see, for example, the seminal work by Nagel (1995) or the more recent paper by Costa-Gomes et al. (2001).} Third, both subgame perfect equilibria imply large payoff dif-
ferences. The extensive experimental evidence on for example the ultimatum game shows that subjects display an aversion to disadvantageous inequality, suggesting that Stackelberg outcomes are unlikely to evolve (see Fehr and Schmidt, 1999 and Bolton and Ockenfels, 2000). Finally, Huck et al. (2002) experimentally investigate the extended game with action commitment of Hamilton and Slutsky mentioned above. The data does not confirm the theory. While Stackelberg equilibria are extremely rare, often endogenous Cournot outcomes and sometimes collusive play are observed.

Notwithstanding these objections and those made elsewhere (e.g. in Pal, 1996) it seems interesting and useful to explore how experimental subjects behave in the two-period market. First of all, the two-period model seems to be more relevant than the one-period Cournot model as real-world firms do have more flexibility in the timing of decisions regarding for example quantities (or capacities), as in the current model, or prices. It is then only desirable to contrast theoretical results with empirical findings. Second, Saloner’s model is part 7 of the growing theoretical literature dealing with the endogenization of market structures. Instead of exogenously assuming modes of play (either simultaneous or sequential), this literature tries to identify factors 8 that might lead to the endogenous emergence of leader-follower or simultaneous-move outcomes. It might then be fruitful to give theorists feedback about the behavioral relevance of such factors by providing empirical evidence. All the more so as the endogenous move structure in oligopoly settings is unlikely to be settled purely on the basis of theoretical arguments. Third, Huck et al. (2002) employed a random-matching scheme. One might argue that fixed matching is more appropriate as it might help subjects to overcome the inherent coordination problem. For example, with repeated interaction, a player is more likely to successfully “teach” the other player. Also, practitioners might suggest that fixed matching is more relevant as in real-world markets firms interact repeatedly. Therefore, fixed matching is employed in the experiments reported here. Finally, the two-period model might give rise to interesting dynamics and adaptation patterns.

The experiments yield the following answers to the three questions asked above. First, in both markets (roughly) symmetric outcomes emerge. Second, after a short adaptation phase average industry output is the same in both markets and lower than predicted by the traditional one-period Cournot model. Third, behavior in the individual two-period markets is quite diverse ranging from pure collusive behavior to behavior that leads to Cournot–Nash industry outputs. Furthermore, on average 83 percent of the total quantity in the two-period markets is produced in the first production period and 17 percent in the second period.

The remainder of the paper is organized as follows. Section 2 reiterates Saloner’s model by means of the market parameters used in the experiments. Section 3 describes the exper-

...
imental procedures. Section 4 presents the experimental results, and finally, Section 5 concludes.

2. Theory

In the following, I reiterate Saloner’s model along with its solution using the specific demand and cost functions implemented in the experiment. For the general result see Saloner’s paper. For the sake of comparison, I shall use the notation adopted by Saloner.

Consider a duopoly market with two production periods and assume that the market clears only after the second period. Firms are assumed to have constant marginal costs of \( c_i = 1 \), \( i = 1, 2 \), respectively, no matter in which period production takes place. In the first production period, firms 1 and 2 simultaneously choose outputs \( q_1^1 \geq 0 \) and \( q_2^1 \geq 0 \), respectively. These outputs become commonly known in the second production period before firms simultaneously choose outputs \( q_1^2 \geq 0 \) and \( q_2^2 \geq 0 \). Firm \( i \)'s total output is denoted by \( q_i = q_i^1 + q_i^2 \). At the end of the second period, the market price is determined by the inverse demand function

\[
P(q_1^1 + q_2^2) = 100 - (q_1^1 + q_2^2).
\]

Firm \( i \)'s best-response function is given by:

\[
R_i(q_j) = \arg \max_{q_i} (99 - q_i - R_j(q_i))q_i = \frac{1}{2}(99 - q_i^j). \tag{1}
\]

(Recall that firms have constant marginal costs of one.)

It is straightforward to show that in the standard Cournot model with only one production period there exists a unique Nash equilibrium which is given by \((N^1, N^2) = (33, 33)\).

Given the timing and the information conditions of the two-period game, a player’s strategy must specify an output for period 1 and an output for period 2 where the latter is a function of \( q_1^1 \) and \( q_2^1 \) (i.e., of the two firms’ first-period outputs). A firm’s strategy is denoted by \( \sigma_i = \{\sigma_i^1, \sigma_i^2(q_1^1, q_2^1)\} \).

Firm \( i \)'s unique Stackelberg leader output will be denoted by:

\[
S_i^1 = \arg \max_{q_i} (99 - q_i - R_i(q_i))q_i = 49.5,
\]

that implies that firm \( j \)'s unique Stackelberg follower output is 24.75. Denote the outer envelope of \( R_1^1 \) and \( R_2^2 \) by \( R \) and define \( E = \{(q_1^1, q_2^1)(q_1^1, q_2^2) \in R, q_1^1 \leq S_1^1 \text{ and } q_2^2 \leq S_2^2\} \). The set \( E \) consisting of all points that lie on the reaction functions between the two Stackelberg points is illustrated in Fig. 1. Saloner shows that the elements of \( E \) are the only outcomes that can be sustained by subgame perfect Nash equilibria.\(^9\)

However, as Ellingsen notes, only the Stackelberg points survive the iterative elimination of weakly dominated strategies. Intuitively, it is the threat that the follower will respond optimally in the second period in case the leader underproduces in the first period that sustains the Stackelberg outcomes (see Saloner, p. 186).

\(^9\) For details, see Supplementary data.
3. Experimental design

The computerized\textsuperscript{10} experiments were conducted at Humboldt University Berlin and at Royal Holloway College (University of London) in November and December 2000.

Upon arrival in the lab subjects were assigned a computer screen and received written instructions. After reading them, questions could be asked in private. All experiments consisted of 25 rounds.

Subjects could choose quantities from a finite grid between 0 and 100 with 0.01 as the smallest step. Hence, the action space had a sufficiently fine grid such that continuous action spaces were approximated. Therefore, the above benchmarks are also valid in the

\textsuperscript{10} We used the software tool kit z-Tree, developed by Fischbacher (1999).
There were two treatments. In treatment “TWO” the two-period duopoly as described in the previous section was implemented. Additionally, as a control treatment, a standard one-period Cournot duopoly (treatment “ONE”) was run. In both treatments fixed matching was used. For each treatment, 10 markets were conducted: 6 two-period and 6 one-period markets were conducted at Humboldt University and 4 two-period and 4 one-period markets were conducted at Royal Holloway College. In all, 40 subjects participated in the experiments.

In treatment ONE, subjects had to decide about the single quantity they wanted to produce in each round. In treatment TWO, however, subjects were informed that each round would consist of two production periods in which production may take place. They were informed that in the first production period both firms would simultaneously decide which quantity they want to produce in this production period and that, then, each firm would be informed about the quantity the other firm has produced in the first production period. Then both firms would decide (again simultaneously) which additional quantity they want to produce in the second production period. Furthermore, they were informed that also in the second production period only non-negative quantities could be chosen. That is, it was only possible to increase the total quantity (or to leave it constant), but it was not possible to withdraw some of the quantity that was produced in the first production period.

Subjects had qualitative information about demand and cost conditions and were able to determine the best reply to an anticipated quantity of the other firm. This information was provided in the form of a ‘profit calculator’ that worked as follows. When fed with data regarding the other firm (total quantity of the other firm), the calculator allowed them to try out the consequences of their own actions. Note that a profit calculator gives qualitatively the same information as a profit table, which is often provided in Cournot experiments (e.g., Holt). Moreover, the profit calculator might help participants to avoid a bias due to limited computational capabilities of subjects. In the second production period of treatment TWO, subjects were asked to feed the profit calculator with an additional quantity of their own firm and an additional quantity of the other firm. The profit calculator would then compute the profit that results from the total quantities of both firms.

After each round in treatment ONE, subjects were informed about their own quantity and profit and the quantity of the other firm. In treatment TWO, they were informed about their own and the competitor’s first-period output before deciding about second-period outputs. After the whole round (consisting of two periods) was completed, subjects were informed about their own quantities and their own profit and the quantities of the other firm.

Whereas one-period market sessions lasted about 45 min, two-period market sessions lasted about 1 h and 20 min. On average subjects earned about US$ 15.

4. Experimental results

Recall that theory predicts that a Stackelberg outcome will emerge in treatment TWO. As a result the firm emerging as a leader should produce a quantity of 49.5 whereas the firm emerging as a follower is expected to produce a quantity of 24.75 resulting in total output of 74.25. In contrast to this, in treatment ONE both firms are expected to produce a quantity
of 33 resulting in a total output of 66. As a consequence, the two-period market in treatment TWO yields higher total welfare when compared to the standard Cournot duopoly market in treatment ONE. So the first two questions I will answer in this section are:

**Question 1.** Do we observe the endogenous emergence of Stackelberg outcomes in treatment TWO?

**Question 2.** Will the two-period markets in treatment TWO yield higher total outputs at smaller prices than standard Cournot markets in treatment ONE, thus, increasing total welfare?

Finally, I will answer

**Question 3.** What is the actual behavior in the two periods of Saloner’s model?

### 4.1. Question 1

Do we observe the endogenous emergence of Stackelberg outcomes in treatment TWO? Recall that the Stackelberg outcome has one firm producing a quantity of 49.5 while the other firm produces a quantity of 24.75 which in an experimental setup is clearly too rigid. Allowing for about 10 percent deviation in action space, an observed outcome \((q^L_1, q^F_1) = (q^L_2 + q^L_2, q^F_1 + q^F_2)\) will be classified as a Stackelberg outcome if \(q^L_1 \in [45, 55]\) and \(q^F_1 \in [22, 27.5]\). Applying this criterion, it turns out that only 8 out of 250 cases can be classified as Stackelberg outcomes. These eight cases, stemming from seven different markets, all occur in the first 10 rounds and not later. Thus it appears that subjects did not even seriously attempt to establish themselves as Stackelberg leaders. In sum, it seems fair to conclude that the answer to the first question is “No”.

### 4.2. Question 2

Will the two-period markets in treatment TWO yield higher total outputs at smaller prices than standard Cournot markets, thus, increasing total welfare? The answer to this question is no, they do not. Table 1 shows summary statistics for the two treatments classified by blocs of rounds. The upper part of Table 1 shows total industry output in the two treatments. The lower part of this Table shows industry output in Treatment TWO for each production period separately. Inspecting total quantities as given in the upper part of Table 1 and concentrating on inexperienced behavior as represented in rounds 1–8, we observe the following: though average total quantity in treatment TWO is with 65.16 higher than in treatment ONE (60.24), these differences turn out not be statistically significant at a reasonable level (\(p = 0.241\), two-tailed Mann–Whitney U-test). Note that according to Table 1, behavior in treatment ONE is remarkably stable over time. In contrast, in treatment TWO we observe that average quantities drop from a level close to the Nash equilibrium prediction during the first bloc to about the same level as in treatment ONE in blocs 2 and 3. Indeed, employing again a

---

11 Inspecting the data regarding the question whether many outcomes would fall only slightly short of this criterion, it turns out that there are only two more cases that might be classified as a Stackelberg outcome: (50, 29) and (45, 21). Each of these outcomes stem from one of the seven markets mentioned in the text.

12 Here, one group’s average total output over the rounds of the considered bloc of the experiment was taken as one observation.
Table 1
Summary of experimental results: total quantities

<table>
<thead>
<tr>
<th>Treatment</th>
<th>First bloc, rounds 1–8</th>
<th>Second bloc, rounds 9–16</th>
<th>Third bloc, rounds 17–24</th>
<th>Last round, round 25</th>
<th>All rounds</th>
</tr>
</thead>
<tbody>
<tr>
<td>ONE total output</td>
<td>60.24 (19.23)</td>
<td>60.62 (12.10)</td>
<td>60.06 (13.68)</td>
<td>65.79 (7.55)</td>
<td>60.53 (15.05)</td>
</tr>
<tr>
<td>TWO total output</td>
<td>65.16 (14.51)</td>
<td>60.93 (13.05)</td>
<td>59.54 (8.59)</td>
<td>66.40 (4.14)</td>
<td>62.06 (12.30)</td>
</tr>
</tbody>
</table>

Treatment TWO: total quantities in each period

| TWO total output in period 1 | 52.54 (14.49) | 51.41 (9.87) | 49.71 (10.84) | 53.80 (9.17) | 51.32 (11.81) |
| TWO total output in period 2 | 12.63 (8.78)  | 9.51 (10.24)  | 9.82 (10.50)  | 12.60 (8.85) | 10.73 (9.88)  |

Note: Standard deviations in parentheses.

Mann–Whitney U-test this time to experienced behavior (i.e., to total quantities in bloc 3 in both treatments) confirms what seems to be obvious to the naked eye: industry output in both treatments is indistinguishable from one another \( (p = 0.88, \text{two-tailed Mann–Whitney } U\text{-test}) \).

One more fact seems to be worth noting, namely that in both treatments there is a notable endgame effect: total outputs clearly rise in the last period and are close to the Cournot–Nash industry output of 66 units.

4.3. Question 3

What is the actual behavior in the two periods of Saloner’s model? To answer this question let us first concentrate on aggregated data. The lower part of Table 1 shows average industry output in Treatment TWO separately for each production period. Let us consider experienced behavior as observed during rounds 17–24. According to Table 1, the average total output in the first production period is 49.71 (which almost coincides with the collusive industry output of 49.5). According to subgame perfect behavior as described by Eq. (3) in Supplementary data, in this case the average market is expected to produce a quantity in the second production period such that the total quantity in both periods equals the Nash equilibrium output of 66. That is, on average we should observe a total industry output of \( 66 - 49.71 = 16.29 \) in the second production period. However, we observe that on average a market produces a quantity of only 9.82 in the second production period.

However, instead of trying to explain this average pattern, let us inspect individual markets. Table 2 displays mean data as observed in rounds 17–24 in each individual market (ordered according to increasing total output). Here, as in the formulation of the two-period model above, \( q_i(q_j) \), \( i = 1, 2 \) denotes the individual quantity produced in period 1 (period 2), \( q' = q_1 + q_2 \) denotes total individual quantity and \( Q = q_1 + q_2 \) denotes industry output at the end of the second production period.

Inspecting Table 2, it turns out that behavior in the individual markets is diverse, ranging from purely collusive behavior (as in markets 1 and 2) to Cournot–Nash behavior (most purely in market 9). All in all, five markets can be classified as collusive (markets 1–5) and five markets can be classified as displaying Cournot–Nash behavior (markets 6–10) in the
Table 2
Average quantities in each market in rounds 17–24 in treatment TWO

<table>
<thead>
<tr>
<th>Market</th>
<th>First period</th>
<th>Second period</th>
<th>Both periods</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$q_1^1$</td>
<td>$q_1^2$</td>
<td>$q_2^1$</td>
<td>$q_2^2$</td>
</tr>
<tr>
<td>1</td>
<td>25.00 (0.00)</td>
<td>25.00 (0.00)</td>
<td>0.00 (0.00)</td>
<td>0.00 (0.00)</td>
</tr>
<tr>
<td>2</td>
<td>25.00 (0.00)</td>
<td>25.00 (0.00)</td>
<td>2.38 (3.89)</td>
<td>1.00 (0.00)</td>
</tr>
<tr>
<td>3</td>
<td>16.13 (10.56)</td>
<td>18.75 (5.18)</td>
<td>13.13 (13.74)</td>
<td>6.25 (5.18)</td>
</tr>
<tr>
<td>4</td>
<td>20.00 (0.00)</td>
<td>21.00 (2.88)</td>
<td>9.25 (3.81)</td>
<td>4.88 (2.70)</td>
</tr>
<tr>
<td>5</td>
<td>26.25 (5.55)</td>
<td>23.38 (8.23)</td>
<td>3.50 (4.93)</td>
<td>9.00 (6.11)</td>
</tr>
<tr>
<td>6</td>
<td>20.00 (0.00)</td>
<td>30.00 (0.00)</td>
<td>10.00 (0.00)</td>
<td>5.00 (0.00)</td>
</tr>
<tr>
<td>7</td>
<td>28.00 (3.16)</td>
<td>30.00 (8.45)</td>
<td>7.38 (4.14)</td>
<td>2.50 (3.78)</td>
</tr>
<tr>
<td>8</td>
<td>33.13 (0.64)</td>
<td>34.63 (0.74)</td>
<td>0.00 (0.00)</td>
<td>0.50 (0.93)</td>
</tr>
<tr>
<td>9</td>
<td>22.88 (12.81)</td>
<td>23.00 (4.54)</td>
<td>12.25 (11.17)</td>
<td>11.25 (4.17)</td>
</tr>
</tbody>
</table>

Note: Standard deviations in parentheses.
Table 3
Average quantities in the four classes of subgames in treatment TWO

<table>
<thead>
<tr>
<th>Class of subgame</th>
<th>Rounds 1–24</th>
<th></th>
<th></th>
<th>Rounds 17–24</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Av. obs. $q_2$</td>
<td>Av. opt. $q_2$</td>
<td>$N$</td>
<td>Av. obs. $q_2$</td>
<td>Av. opt. $q_2$</td>
<td>$N$</td>
</tr>
<tr>
<td>I</td>
<td>2.52</td>
<td>0.00</td>
<td>44</td>
<td>0.63</td>
<td>0.00</td>
<td>16</td>
</tr>
<tr>
<td>II</td>
<td>5.38</td>
<td>9.78</td>
<td>364</td>
<td>5.59</td>
<td>9.95</td>
<td>132</td>
</tr>
<tr>
<td>III</td>
<td>3.39</td>
<td>0.00</td>
<td>36</td>
<td>0.00</td>
<td>0.00</td>
<td>6</td>
</tr>
<tr>
<td>IV</td>
<td>10.21</td>
<td>7.15</td>
<td>36</td>
<td>6.33</td>
<td>3.42</td>
<td>6</td>
</tr>
</tbody>
</table>

last third of the experiment. Note also that Table 2 provides no evidence for the endogenous emergence of Stackelberg outcomes in treatment TWO.

Comparing total individual quantities of the two firms in a market as shown in Table 2, it seems fair to conclude that on average roughly equal market shares evolve. However, in some of the groups market shares are quite different. This is particularly so in market 7 and (to a lesser degree) in market 4. In market 7, for example firm 1 earns in all rounds of the third bloc 14.3 percent less than firm 2. Although, as it is evident by now, there are almost no outcomes that resemble Stackelberg market shares, one might ask whether market shares in treatment TWO are on average more uneven than in treatment ONE. To answer this question, I assign to each of the individual markets (for each round separately) the number $s = \max\{q_1, q_2\}/\min\{q_1, q_2\}$.

As it turns out, in rounds 1–24 the average $s$ for treatment ONE is only slightly higher than the average $s$ in treatment TWO: 1.29 versus 1.17 (standard deviation: 0.67 versus 0.26). In rounds 17–24 similar numbers emerge: 1.20 versus 1.10 (standard deviation: 0.77 versus 0.13). In fact, applying a Mann–Whitney $U$-test to each round (neglecting non-independence across rounds) reveals that the differences are insignificant in each round. Note, furthermore, that differences across markets are smaller within treatment TWO as standard deviations in this treatment are smaller than in treatment ONE.

Let us finally and briefly explore actual behavior in the second production period in treatment TWO. Recall from Eq. (3) in Supplementary data that behavior in the second stage depends on the individual quantities produced in the first stage: whereas a firm should cease production in classes I and III, it should produce up to the Cournot–Nash output (i.e., up to its best-response to the other firm’s first-period output) in class II (IV). Table 3 shows average observed second-period quantities in all of these four classes along with the average quantity that would have been optimal according to the subgame perfect equilibrium, separately for rounds 1–24 and 17–24 (experienced behavior). Several observations are in order. First, in accordance with what was said above, most observations belong to class II (i.e., to the case in which both firms have produced less than the Cournot–Nash output in the first period): 364 out of 480 cases (rounds 1–24) and 132 out of 160 cases (rounds 17–24). Second, no matter which time interval one considers, on average firms produce less than what would have been optimal in class II: 5.38 versus 9.78 (rounds 1–24) and 5.59 versus 9.95 (rounds 17–24). That is, as we already know, on average firms do not produce up to

13 There are two rounds in treatment ONE, in which one firm produced 0. Therefore, these two cases are excluded.
the Cournot–Nash quantity as it is required by subgame perfect behavior in this class. In other words, firms act somewhat collusively. Third, again independent of the time interval considered, on average firms produce more than what would have been optimal in class IV: 10.21 versus 7.15 (rounds 1–24) and 6.33 versus 3.42 (rounds 17–24). Note that in class IV, the other firm’s first-period output can be much higher than the first-period output of the own firm. Thus, an output beyond of what would have been optimal can be interpreted as an attempt to balance market shares. Fourth, subjects appear to have learned over time to cease production in classes I and III: average observed quantities in periods 17–24 are (close to) 0 in these cases whereas this is not the case in the first two-thirds of the experiment which becomes apparent by looking at the respective numbers in periods 1–24. In all, it appears that learning leads to second-period behavior that over time moves closer to the subgame perfect equilibrium prediction.

5. Discussion

Giving firms more flexibility with regard to the timing of decisions, Saloner studies an extension of the standard Cournot model by allowing firms to produce in each of two periods before the market clears. As a result, a continuum of equilibria arises in this model: all points in the outer envelope of the best-response functions between and including the Stackelberg points can be sustained as subgame perfect Nash equilibria. However, as noted by Ellingsen, only the Stackelberg points survive the iterated elimination of weakly dominated strategies. Thus, even a-priori symmetric firms are predicted to end up in asymmetric positions. Contrary to this prediction, the main result reported in this paper is that about symmetric outcomes emerge in the experimental two-period markets. Moreover, when subjects are experienced, average industry outputs in two-period markets are the same as in one-period Cournot markets. Also, the bulk of the industry output (namely on average 83 percent) is produced during the first production period.

The endogenous emergence of Stackelberg outcomes in experimental duopoly markets with flexible timing appears in the light of the experimental results presented here and elsewhere as very unlikely. Thus, more theoretical work is needed to explain why asymmetric equilibria do not emerge often when players are symmetric. Some reasons why this is not the case seems to be the following. First, subjects’ aversion to disadvantageous inequality as conceptualized in, for example, Fehr and Schmidt (1999) and Bolton and Ockenfels (2000) seem to be too strong to allow symmetric (as well as asymmetric) firms to end up in asymmetric positions. Second, subjects appear not to see a way to get around the coordination problem that plagues asymmetric outcomes. Finally, as earlier studies show, too, subjects do not iteratively eliminate dominated strategies (over “many” rounds).

14 As mentioned in the introduction, Huck et al. (2002) test Hamilton and Slutsky’s extended Cournot model with action commitment and symmetric firms. Fonseca et al. (2005) test the same model with asymmetric firms. van Damme and Hurkens predict for this case that the low-cost firm should emerge as the Stackelberg leader. However, Stackelberg outcomes are, again, extremely rare.
Acknowledgements

I thank Dirk Engelmann, Arno Riedl and the co-editor David Grether for helpful comments. The author acknowledges financial support from the German Research Foundation, DFG. Furthermore, he thanks the Center for Experimental Social Science (CESS) at New York University (where part of this research was done) for its hospitality.

Appendix A. Supplementary data

Supplementary data associated with this article can be found, in the online version, at doi:10.1016/j.jebo.2004.06.025.

References