Oligopoly Regulation
Short Note

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1 Oligopolies & Anti-Trust Regulation

Anti-trust regulation prevents concentration of market power - something which is seen as detrimental because of monopolistic power leads to inefficiency (deadweight losses) and prohibitive prices ($P > MC$) for consumers. In the case of oligopolies, where there are a few firms selling the same or very similar products, the possibility of *collusion* (or to use the metaphor of the Prisoner's Dilemma, cooperation between players) can cause an oligopolistic market to behave like a monopoly. Typically, oligopoly firms do this by colluding on prices. Since prices are negatively associated with demand, maintaining a higher price involves agreement about how much to restrict quantity (think OPEC!). This is where the usual need for anti-trust regulation comes in - legal checks and balances to ensure that firms cannot collude to raise prices by creating artificial scarcity and cause inefficiencies.

However, there are some kinds of exercise of market power that do not involve the kind of direct collusion as mentioned above, but are still scrutinised by anti-trust legislation.

1. **Resale Price Maintenance**: The idea is that an upstream firm (say, a wholesaler) who sells commodities to a retailer puts a lower cap on how much the retailer can charge for the product. For example, if upstream firm A sells a product to retailer B at $ 100, then A mandates that B cannot sell the commodity to the final consumer at less than $ 200. This ensures that A can charge a $ 100 for the product (which is above the MC for Firm A), and downstream firms do not reduce the price to sell more (think, discounts!). This ensures the maintenance of firm A's selling price. This is, in a sense, a price control, and a violation of anti-trust law. On the other hand, it is believed that this kind of resale price maintenance is not an exercise of market power – Firm A could have just increased its own price than setting a *resale* price. Moreover, the objective of setting a resale price seems less to appropriate more profits (since the resale price is only a lower bar to the final price the consumer faces; the retailer can certainly charge a higher price and gain). Rather, it is that the higher price provides a certain quality and service provision in the sale of the commodity. For example, Range Rover might set a resale price for its franchises so that they can provide a good consumer experience in their showrooms. As such, it is the belief of some economists that it does not require anti-trust action.

2. **Predatory Pricing**: Oligopoly firms can compete in setting quantities (and thereby raising the market price) or by setting prices. In the latter, the objective is to undercut the price of the competitor to gain a larger market share. This is called a game of Bertrand competition. Think about how Jio provides data at much cheaper rates than its competitors, and thereby acquires a large part of the market. Indeed, the mobile network market in India is an oligopolistic market. Slashes prices to crowd out competitors is called predatory pricing. However, there is no clear reason about why anti-trust action should be taken against such firms because (1) this is not detrimental to consumer welfare – they are facing lower prices; (2) if prices are drawn to very low levels, firms will start incurring losses, will cut back on their quantity, and go out of business. The firm engaging in predatory pricing will *have* to serve a larger market with lower margins or even losses and in such a situation, the competition firm not engaging in predatory pricing may

survive. It is difficult to distinguish, often, if a cut in price is predatory or not – and as such, anti-trust action may not be the best way to deal with such a situation.

3. **Tying**: This is a form of bundling commodities together and selling them. FOr example, a best-selling flavour of ice-cream is combined with a badly-selling flavour at a combined price – those who want to purchase the best-selling flavour may be willing to pay a little more to get two ice-creams. This expands sales, and can be construed as taking up a larger share of the market. There is skepticism regarding whether this construes anti-competitive behaviour. To some degree, there is a tendency of economists to suggest anti-trust legislation in the case of tying, is because tying is one way monopoly firms try to price discriminate. If I have a willingness-to-pay of $ 120 for bubblegum flavoured ice-cream (a best-selling variety) and a willingness to pay of $ 10 for mint-chocolate (a badly-selling variety). You on the other hand, like mint-chocolate more and are willing to pay $ 120 for it. If these ice-cream scoops were not tied together and the seller had to sell them separately, she seller would charge $120 per scoop, I would buy bubblegum and you would buy mint-chocolate. The seller would make $240. If, on the other hand, tying was practiced, the seller could bundle bubblegum and mint-chocolate at $130, and both you and I would buy both ice-cream flavours. The seller has now appropriated the low but non-zero willingness to pay we both had for our own non-favoured ice-cream flavours, and that leaves the seller with $ 260 i.e. higher profits, and higher sales, and thereby, higher market power. Nonetheless, this is not *strategic* action, based on the actions of competitors, and as such, it cannot be established that such schemes are always anti-competitive.