

Profitability and Collusion: An Experimental Investigation^{*}

Subhasish M. Chowdhury,^a Stephen Davies,^b Joo Young Jeon,^a and Frederick Wandschneider^c

^a School of Economics, Centre for Behavioural and Experimental Social Science, and Centre for Competition Policy, University of East Anglia, Norwich NR4 7TJ, UK

^b School of Economics and Centre for Competition Policy, University of East Anglia, Norwich NR4 7TJ, UK

^c Alix Partners LLC, 20 North Audley Street, London W1K 6WE, UK

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Abstract

We study the effects of profitability on collusive behaviour. In specific, given the same anti-trust deterrence mechanisms in place for two markets, we investigate which market is more affected with collusive behaviours in terms of attempt to collude, actual cartel formation, prices charged, and the stability of the cartels. Since there are two counteracting motives with higher profits viz. higher incentive to collude, and higher incentive to defect; but standard theories do not provide a specific result and it is impossible to obtain field data, we implement a laboratory experiment to answer these questions. We find that the collusive behaviours are indeed different in markets with heterogeneous profits. Both propensity to collude and actual cartel formation are higher in the low-profit market. The prices charged by explicit cartels are not different in the two markets, but prices charged by non-cartel firms, when communication is possible, are higher in the low-profit market – indicating possible tacit collusion. Moreover, experienced colluding firms in the high-profit market are less likely to deviate from agreed cartel price than their low-profit counterpart. These results indicate more occurrences of cartels in low profit markets, but more stable cartels in high profit markets, and seek for further investigations in this area of research.

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* Corresponding author: Subhasish M. Chowdhury (S.Modak-Chowdhury@uea.ac.uk)

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