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**An enquiry of Kinked Demand Oligopoly Market:  
Theory, Evidence and Policy Implications from Lakshadweep**

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**Abstract**

There are number of markets discussed in the economic theory seems only as imaginative and lacks proper investigation on the existence in the real world situation and their validity. The kinked demand curve hypothesis is a famous one among them which is under crux among the economic researcher. In the past few decades the existence of this market in the real world economies and its impact is continue to be a puzzle and a very few attempts were made in this areas with a few oscillating conclusions. With this backdrop this attempt is made to fill this gap in economics literature of re examining the existence and the impact of the kinked demand theory hypothesis with a special reference to Lakshadweep islands of India.

**Keywords;** Kinked Demand Hypothesis: Kinked Demand Evidence and Consequences, Sticky prices, Co-ordination failure, Real Rigidities/Micro Economics theory and Consequences

**JEL Codes :** A1,A2,D4,D6,D43,D61,E6,F6,H4,H5and R1

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### **Premises, Background and Research Gap**

There are number of markets discussed in the economic theory seems only as imaginative and lacks proper investigation on the existence in the real world situation with validity. The kinked demand curve hypothesis is a famous one among them which is under crux among the economic researcher. In the past few decades the existence of this market in the real world economies and its impact is continue to be a puzzle which are not available to explain well from the present perfect competition, monopoly, and monopolistic competition about which a very few attempts were made in this areas with a few oscillating conclusions about the its existence, causes and impact to the real world market economy (Gavin C Raid (1981), Bhaskar, V., (1988), Debapriya Sen(2004), Maarten Dossche , Freddy Heylen, Dirk Van den Poel (2006), Stephane Dupraz (2017).

### **Objectives**

With this backdrop this attempt is made to fill this gap in economics literature of re examining the existence and the consequences of the kinked demand theory hypothesis with a special reference to Lakshadweep islands of India.

### **Methodology**

In the light of the economics literature this paper is attempt to theoretically investigate and graphically explain the existence of the kinked demand of oligopolistic market and trace out the causes and guides appropriate policy adjustment.

### **The Core Idea of the Theory**

The implications of the kinked demand theory of oligopoly can be summarized as...

1. The oligopolistic face a demand curve with a kinked portion with relatively high elasticity and low elasticity of demand.
2. The price of the oligopolistic products will never change irrespective of the output produced and the marginal cost of the production.
3. If any oligopolistic increase his price no one will follow him: at the same time if any one reduced the price of the product everyone will follow his price cut (Paul M Sweezy , 1939).

## Assumptions

Many reviews give new ideas while changing the assumptions. Stéphane Dupraz (2017) isolated the key assumption responsible for price rigidities of kinked demand oligopoly market and attempted to correlate the menu cost model and the Phillips curve. In order to make a theoretical validation of this kinked demand theory the underdeveloped island economy has chosen from Lakshadweep islands and its cascading effect is analyzed through light on providing the higher education in Lakshadweep with the following the additional realistic assumptions to the theory already prevailed.

1. The producers and the providers (Faculties) of higher education are assumed to be an oligopolistic market. ( In order to ensure the social security measures of the island citizens the administration of the union territory of Lakshadweep has been following the procedure of appointing the a fixed proportion of the island faculties with minimum basic qualifications and the mainland teachers with maximum qualification )
2. The cost of providing the higher education to the producers is assumed to be zero while it is claimed by the Calicut University from the Prime Minister Disaster relief fund.
3. Everything is a product in economics and the value of it is usually measured in terms of its price. Higher the value higher will be the price and vice versa.
4. Higher education is assumed as a product and the result, employability are assumed as the output of higher education to the island economy.
5. Due to the uncertainty of enrolment in the higher education and the temporary nature of the university centers in the islands, faculty members are appointed on purely contract basis and their contract extensions are subjected to the performance evaluations of the students.
6. The demand curve for higher education faced by the oligopolistic teachers is assumed to be with kinked portion. (It is the present situation of the Lakshadweep in which some students enrolled into the collage with objective to get a degree with the sufficient knowledge and the rest of the students are enrolling into the higher education just to time pass and to visit the mainland through the grant study tour every year.
7. Consumers are rational and adoptive rational expectation hypothesis exist. With the above assumptions the kinked demand hypothesis can be analyzed as under.

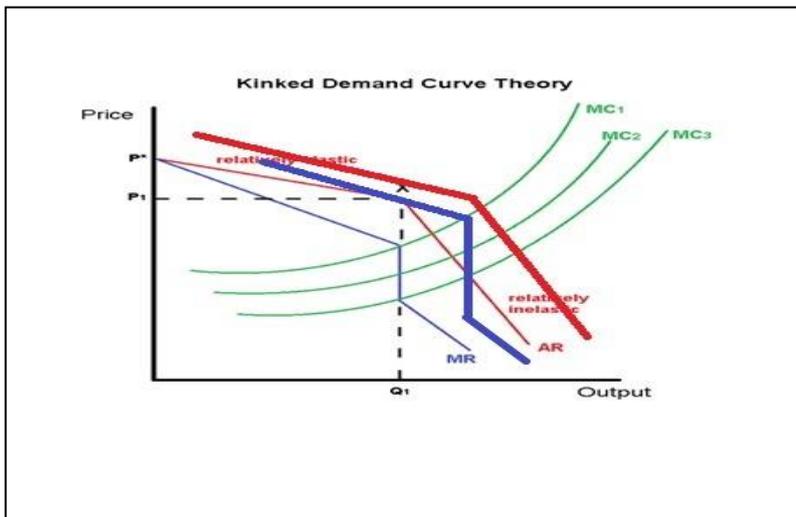
In order to provide social justice to the island citizens a considerable portion of the teaching jobs are allotted to the island graduates based on minimum qualification. The remaining portion of the jobs filled by the mainland graduates after cleared nationwide competitive interview. The island teachers have relatively less elastic demand curve for their teaching which means they apply the easy and traditional mode of teaching and usually unwilling to take up any modern challenges to meet the sky rocket competitive education and its challenges due to their job security. On the other hand the teachers who follow the high tech teaching practices ,modern and improved evaluation procedures with always ready to take any form of academic challenges and additional responsibilities faces the demand curve with relative more elastic which means the demand for their teaching will go down when they strict in evaluation procedures.

If the mainland oligopolistic teachers fix their price or value of their teaching at the high level to meet the cutting edge competition the demand for their teaching will change drastically and the others oligopolistic teachers will not follow it in fear of losing their job which is based on the student's evaluation.

On the contrary to his if they fix very lowest price for their teaching like unethical and strictness in evaluation procedures, assigning the internal marks without properly conducting the seminar, test, and the assignments and repeated subject discussions will attract the students and cause them to educate the other teachers to work with lowest grade. So everyone will follows it and continue to practice the same poor quality teachings. This situation leads the students to be locked with prolonged poor results and inability to utilize the employment opportunities available in the Lakshadweep.

As a result of this oligopolistic nature of this higher education practices the value of higher education in Lakshadweep islands is interlocked as rigid one and the output of this three centers are also has not improved for the past two decades. It proves the work of V. Bhaskar, S. Machin and G. Reid (1991) that tested about the kinked demand oligopoly market and concluded that there exists some asymmetry in expected response to changes in the price. This can be explained with the help of the following diagram...

**Figure 1: Kinked Demand Theory of Oligopoly**



In the above figure 1, the demand curve faced by the oligopolistic teachers is expressed as the usual kinked demand curve DPd with a kinked portion at the point P. The first portion DP represents the relatively less elastic demand curve and the portion Pd represent that the relative less elastic. It means that the oligopolistic teacher who have high elasticity of demand and follows high performance in teaching by adopting the standard practices ( which required heavy efforts, hard work and dedicated preparation and classroom observation by the students) will reduce the demand for him. On the other hand if the teachers who are unwilling to follows the high performance with high standard by referring the standard book and prepare high standard notes and try to make the students to achieve the maximum score in the exam they will purposively reduce the quality of the service by allowing the students to do not participate in the class room and escapes to study will force the others to follows as a result the entire system will reach a state of market for lemon.

**Changing the cost of education will not improve the price (value) of the education:**

As in the case of usual kinked demand theory of oligopoly the changes in the marginal cost will never affect the price of the product. The price of the product in this case is assumed as the value of degree which shows the static for the past few decades even after the marginal cost has increased by many fold. The allotment and utilization of the fund for the Lakshadweep higher education secondary data shows and the respective students output (pass out) from the college and their employment status at the present highlighted in the table below proves this attribute.

**Changing the output of the oligopolistic teachers will not affect the price (value):**

The second aspect of the kinked demand hypothesis regarding the output and its relation to the price can be seen as follows. It proves that the changes in the output units will not affect the price or value of it. The number of graduates passed out from the center for the past two decades has no impact on its price even though it has increased considerably. So the shift in the output will shift the demand curve of the oligopolistic either in to left or right it has no claims to change the price of it.

**Policy Recommendation to breakdown the kinked demand nature of higher education:**

To break this kinked demand theory's impact on the higher education of Lakshadweep there is a need to establish multi dimensional policy framework as discussed under...

The present practice of providing the social justice through first preference to islanders should be violated and the strict standards to be followed in the appointment of the teachers. Otherwise it would become the meaning of injustice to the present graduates in the name of justice to past graduates. Secondly the teachers who are with the attitude of shirking in their duties should be identified given proper skill improvement opportunities either by allowing to utilize the refresher course in the mainland or by arranging such refresher courses in the islands at least every two year. The present zero monitoring tendency of the higher education should be changed and proper monitoring mechanism has to establish to ensure crores and crores of money spent on education in the name of investment in human capital. Everything should have a price. If anything is given in plenty of quantity for longer period at free of cost, no consumer will be ready to purchase it and suspect it. So there should be some limitation of subsidy in education based on critical minimum effort thesis.

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