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Price Rigidity and Industrial Concentration: Evidence from the Indonesian Food and Beverages Industry*

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This paper investigates the relationship between industrial concentration and price rigidity in the Indonesian food and beverages industry. A Cournot model of firm behavior is used in which prices adjust according to a partial adjustment mechanism. The model is applied to panel data of the Indonesian food and beverages industry over the period 1995–2006. The results suggest that industrial concentration has a positive effect on percentage price changes. Furthermore, the speed of price adjustment is higher when the per unit cost of production rises.

Keywords: food and beverages industry, industrial concentration, oligopoly structure, price rigidity, speed of price adjustment.

JEL classification codes: L11, L16, L13, L22.

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I. Introduction

Price rigidity is defined as the condition where some prices adjust slowly in response to changes in per unit cost of production or changes in supply or demand.[1] Means (1935) uses the term 'administered price' for a price that does not change frequently in the oligopoly structure because of market power. Price rigidity is among the most important economic issues for economic policy-makers as it can cause inefficiency in the allocation of resources (Carlton, 1986). An important factor influencing price rigidity is the degree of industrial concentration (see Stigler, 1947; Carlton, 1986; Bedrossian and Moschos, 1988; Caucutt *et al*., 1999). A few large firms operating in an industry characterized by high industrial concentration may use market power to control the price level as well as variations in the price level.

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1 The concept of the kinked demand curve was introduced by Sweezy (1939), who also defined price rigidity as slow price adjustment with respect to the other competitors' strategy.

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