

Entry-Deterrence Contracts under a Price-Ceiling Regulation

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Many utility industries have experienced an asymmetric regulatory environment in which a natural monopoly firm serves several markets and faces a threat of entry in some of the markets. In this paper, a simple model is constructed to consider an asymmetric regulatory environment. We deal with a price-ceiling regulation as a monopoly regulation. A main feature of the model is that a natural monopoly has an opportunity to offer a contract, which has an entry-deterrence property, to customers in competitive markets.

The analysis in this paper shows that the first-best allocation is infeasible under partial price-ceiling regulation because of an incumbent's strategy to offer an entry-deterrence contract. However, it is also shown that the contract can have welfare-enhancing property through the exclusion of cream-skimming, especially when the level of a regulated price-ceiling is low. Lastly, we see that the contract does not always deter an entry: It inspires entry when the level of price ceiling is high.

Key words: asymmetric regulation, entry-deterrence contract, cream-skimming, price ceiling.

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