

Market structure and Political influence: Role of product differentiation and innovation

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Abstract

This paper studies the interrelation of market structure and political influence in a differentiated goods market. Political rules and regulations affect the operation of firms. Similarly, the power that firms hold also determines political decisions. We develop a model to capture this co- determination in the presence of innovation and product differentiation, where the policymaker aims to maximize bribe by setting a minimum quality standard. Firstly, in the one-period model, we find that high horizontal product differentiation results in low competition and thus the lower- quality firm pays higher bribe. The policymaker will not intervene and by setting a minimum quality standard that both firms can satisfy. On the other hand, low product differentiation results in high competition and thus the high-quality firm pays higher bribe. The policymaker will intervene by setting a minimum quality standard that only the high-quality firm can satisfy. Secondly, in the two-period model, period 1 is the same as in the one-period model. Policymaker's objective is to maximize total bribe earned in both the periods. If horizontal product differentiation is high, intervention doesn't take place in period 1. Then both firms will innovate in period 2 and duopoly will prevail as the policymaker will not intervene in period 2 as well. In contrast, if horizontal product differentiation is low, intervention takes place in period 1. Then only the high-quality firm will innovate in period 2 that can either lead to Natural monopoly or Forced monopoly.

Keywords: Market and political power; Political influence; Product Differentiation; Innovation

JEL classification: D42, D43, L13, M14, P11