

Entry and Exit in a Price Regulated Industry

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Abstract

The goal of this paper is to empirically examine the effect of price floor regulations on firms' entry and exit decisions. In particular I study the dynamic decisions of gasoline stations using a structural econometric approach. I measure the impact of a specific price floor regulation by observing firms' behavior before and after the implementation of the policy. The data used to estimate the model is a panel of local markets in Canada between 1991 and 2001.

Strategic interaction between local competitors is modeled as a dynamic game between neighboring stations. I estimate the parameters of the model using the conditional choice probability estimator of Hotz and Miller [1993], as suggested by the recent literature on the estimation of dynamic discrete games. I then evaluate the effects of the policy by computing the difference between the continuation values of firms with and without the regulation.

The results show that the price regulation had a significant impact on a firm's option value of staying in the market. A consequence of this is a lower exit probability, which led to a slower re-organization of the industry. Moreover, the impact of the policy is shown to have a larger positive impact on weaker stations (i.e. smaller stations using an older technology).

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