Competition and Pass-Through: Evidence from Isolated Markets

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We measure how pass-through varies with competition in isolated oligopolistic markets with captive consumers. Using daily pricing data from gas stations, we study how unanticipated and exogenous changes in excise duties (which vary across different petroleum products) are passed through to consumers in markets with different numbers of retailers. We find that pass-through increases from 0.44 in monopoly markets to 1 in markets with four or more competitors and remains constant thereafter. Moreover, the speed of price adjustment is about 60% higher in more competitive markets. Finally, we show that geographic market definitions based on arbitrary measures of distance across sellers, often used by researchers and competition authorities, result in significant overestimation of the pass-through when the number of competitors is small.