Oligopoly: An Explanation and Comparison Between Capitalist and Islamic Economics Theories.

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Abstract

Nowadays, competitions in economic sectors are really intense. Every firm try to get a higher profit as its firm can. To reach that point, they really dare to do everything, whatever it takes.

The capitalist experts make a theories of market and art of business. They make a classification to a market with some different characteristic. There is Perfect Competition, Monopoly, Oligopoly, etc. according to its market characteristic. Here I want to make an analysis about Oligopoly market, how its definition according to Capitalist (here we call it as Conventional) and what Islamic Economics experts say about it according to Al-Qur’an and As-Sunnah, also a comparison between the two parties. In the end, I hope with the fact that I provide to you, you can compare which is the best and lead to gloriousness, happiness and give the benefit to both sides, the firm and the costumers.
1. Introduction

Economic activities become an important activity in development and rotary of human races. People will buy everything to fulfill their life’s needs. To complete this circle, they needs to work to earn money on one side and another side needs to produce goods and service to fulfill the demands and also to earn their money. Based on that circle we know that selling and buying (i.e. Economic Activities) is not to get profit and fulfill our needs only but also to still human races from the distraction. (Al-Ghazali quotes)

Nowadays it became more complicated when people think business is just for reaching the biggest profit. Too many ways to do that, and there’s an art for people to sell their goods and services. One of them is to control the market.

There is some theories of the market. Perfect Competition Market, Monopoly Market and Oligopoly Market. My focus here to talk about Oligopoly Market. I will explain about Oligopoly Market definition by Conventional View and Oligopoly Market by an Islamic view. The definitions by a conventional economic experts and What Islamic Economics Experts say about conventional theories.

From Islamics side, I just want to provide some of Islamics Economics expert’s opinion of the market. Because in Islamic economics theory, there is no such bright line to give a classification that kind of market. As additional information, people who “play” in Oligopoly Market also can have a power like Player in Monopoly Market in some cases, and I will explain it to you deeply with some evidence and information to prove my arguments. So you can compare and decide which is the best, more equals and more fair in the end of this paper trial.

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1 Karim, Adiwarman. *Ekonomi Mikro Islami* (Rajagrafindo Persada)
2. Objectives of Writing

In this paper, I would like to explain the capitalist theories about basic Oligopoly market term, which is has a special characteristic, and then compare it with Islamics theories and how the Islamics experts opinion about the market with literature which is happen in Rasulullah S.A.W and Caliphate ages as an evidence.

Too many people still in murk in understanding Islamic economics theories, meantime some of people really awake and realize that Islamics economics theories can be an alternative getaway from this hard economic situation. I hope, in the end of this paper work, the readers can compare between these two theories with clear mind and bright knowledge so they can consider which one is the best to be applied.

3. Definitions of Oligopoly

3.1 Conventional Economics Definition

Oligopoly is one of market term where there’s a small number of seller. Some of economic experts define it “more than one but less than ten”. However, in the fact mostly what happen is two seller who running in business. This term also called as Duopolies\(^2\). Let’s see the definitions of Oligopoly Market Theory the conventional one and the Islamic one by the Economic experts view.

Ahlersten (2008) in his book says that “An Oligopoly is a market in which there are only a few sellers.” And then he put more information for addiction, he said that “…… Most of the models in the literature only cover cases in which there are two sellers. Such markets are also called duopolies……”\(^3\)

Parkin (2003) wrote in his book that Oligopoly is “….like monopolistic competition, lies between perfect competition and monopoly…”\(^4\)

After the definition, Parkin describes that Oligopoly term is a market structure in which has some character. First, Natural or legal barriers prevent the entry of new firms. And second, a small number of firms compete.

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\(^3\) ibid

He also added some information about natural Oligopoly. He said that Natural or legal barriers to entry can create oligopoly. Economies of scale and demand form a natural barrier to entry that can create a *Natural Oligopoly*.

As example, let’s imagine that there’s just only two of taxi firm available in the city. They try to fulfill the demand from the citizen. Here’s the illustration of two natural Oligopolies:

![Figure 1](image-url)

The demand curve, D in both parts of the illustration (figure 1 and figure 2), shows the demand for taxi rides in a City. If the average total cost curve of a taxi company is ATC in a first part, the market is a natural duopoly – an oligopoly market with two firms.

The lowest price at which the firm would remain in business is $10 a ride which is the minimum average total cost. At that price, the quantity of rides demanded is 60 a day, when a firm produces 30 rides a day, the efficient scale, two firms can satisfy the market demand. There is no room in the market for three firms. But if there were only one firm, it would make an economic profit and a second firm would enter to take some of the business and economic profit.

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If the average total cost curve of a taxi company is $ATC_2$ in second part, as seen below. The efficient scale of one firm is 20 rides a day. This market is large enough for three firms. A legal oligopoly arises when a legal barrier to entry protects the small number of firms in a market. A city might license two taxi firms or two bus companies, for example, even though the combination of demand and economies of scale leaves room for more than two firms. This natural oligopoly has three firms.

![Figure 2](image)

Economic experts using a kinked demand curve (as seen on Figure 3) to show how oligopoly market terms activities in its market. Ahlersten K. (2008) in his book explained about how this curve work.

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He said that the bend in demand curve makes the construction of the MR curve more complicated. To find the MR curve, we extend the two parts of the demand curve, D, until they reach the two axes. (The extensions are the thin lines in the figure.) As the (real and imagined) demand curves are downward sloping, intercept the Y-axis at the same points, but have a slope which is twice as large. Since D now has two parts, we do this for each part separately.

He adds... “…since the demand curve is bent at the quantity q*, the MR curve will also change at that quantity. To the left of q*, we use the MR curve that is derived from that part of the demand curve that is valid to the left of that quantity. To the right of q*, we instead use that MR curve that is derived from the part of the demand curve that is valid to the right of it. This causes the final MR to make a jump at q*. In the figure, the final MR curve is indicated with thick full lines. The parts that are not used, since they correspond to the extensions of the demand curve, are indicated with thick dotted lines.

Just as before, a criterion for profit maximization is that the firm sets the quantity where MR=MC. In the models we have used this far, that criterion singled out exactly one point. However, since the MR curve now makes a jump at the quantity q*, the MC curve can intersect the MR curve in that interval. At the prevailing price, it must do so by construction.

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This means that if the marginal cost, MC, only changes a little bit, for instance because a small tax is introduced on each unit sold, the firm might not change its produced quantity, and consequently not the price. As long as the MC curve still intersects the MR curve at the jump, the firm will produce the same quantity, \( q^* \). However, the increase in MC will lead to a reduction in profit for the firm...

This is the one way that the real-world phenomenon of sticky prices can be explained. According to another market-models (Perfect Competition and Monopoly), price should change immediately if quantities change. However, often we see that prices change more seldom; they seem to be stuck at a certain level for a while. If prices and quantities are set according to the kinked demand curve-model, however, this is exactly what we should expect.
3.2 Islamics Definitions

In opposites of Conventional Economic theories that flexible and not permanent, Islamic Economics Theories are fixed and permanent because its theories sourced from Al-Qur’an and Al-Hadith (As-Sunnah). As we know, Al-Qura’n and As-Sunnah are fixed, and cannot be changed by anybody.

Basically, in Islamic economics theories there is no such detail classification to a market. As we can see in Islamic economic literature, the Islamic economic experts just making an analysis about the market character, giving their opinions about it and talking about how the market circulation should be based on Al-Qur’an and As-Sunnah. Entire theories of Islamic Economic are sourced from Al-Qur’an and As-Sunnah, so all the terms in it has a relation with Islam, with Religion and God.

One of main parameter of market classification is a price. How price can be picked by a market in perfect competition market and some cases in Oligopoly market, and how price can be stated by a firm in monopoly market and some of oligopoly market.

Karim A. (2007) in his book says that the first Islamic literature explains about how fluctuation on price affecting number of production that can be found is Abu Yusuf”s opinion. He says, “… there is no exact limit about how cheap and expensive can be ensured. That’s matter already controlled. And the principle is unknown. Prices decreasing are not caused by foods abound, and so prices increased are not caused by foods austerity. Prices decreasing and increased are Allah’s will. Sometimes foods are abound but prices are still high, and sometimes foods are hard to find but the prices are cheap....”8 Even there is no such detail classification in Islamic economics theories, one of Islamic economic experts, Ibn Taimiyyah has discussed about price level set by government and also commenting about monopoly, oligopoly and monopsony.9

The main idea of Islamic Rules is to bring happiness to people or in Arabic we called it “Rahmatan Lil ‘Alamin”. In the economic sector, we can see that the main rules of the

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8 Karim, Adiwarman. *Ekonomi Mikro Islami* (Rajagrafindo Persada) 141
9 Ibid
transaction or other activities in Islamic economic is based by *Taraadheen*[^10]. That’s mean there’s no pressure and each side is really know what they doing (’Adm Gharar).


“In Islamic concept, Monopoly, duopoly, oligopoly are not prohibited its existence, as long they are still taking reasonable profit. This is the consequences of ‘the price of the equivalent’ concept. The firm that operated with positive profit will give interest to the other firms to play in its business sector, so the supply curve will move to the right side, the output quantity will increase, and the price will decrease. A new firm will stay enter the business until the price decrease so economic profit will be impossible. At this condition, the firm(s) that is already in a market did not have any incentive to leave the market, so do the firms that not enter the market yet have no incentive to enter the market.[^11] Islamic rules are set for justice in every competition at the market. Every forms, moves and actions that can cause unstable and unfair condition are prohibited.”[^12]

[^10]: Arabic means no one has under pressure or in hard situation in making the agreement or transaction. Both side of agreement maker or transaction maker is on conscience and happy with the agreement and transaction.

[^11]: *Long run competitive equilibrium* happens when the three conditions are completed. First, every firms in its industry are trying to maximize their profit. Second, there’s no firm has an incentives whether to enter or to leave the market because the economic profit is impossible. Third, the price has arranged in such a way so the quantity of supply same as quantity of demand. Please read Robert Pindyck and Daniel Rubinfeld. *Microeconomics* 3rd ed., (New Jersey: Prentice Hall, 1995)

4. Comparison

In this section I would like to make some comparison between the conventional theory about Oligopoly Market term and how Islamic Theory put the position of the market.

Conventional economics has an advantage and disadvantage. The firms who run their business in this market should have a big amount of capital, because the market also gives an disadvantage to every firms. Every firm will be interdependence, that is mean they really depend their action to another firm act.\(^\text{13}\)

Parkin (2003) made an example in his book, “….With a small number of firms in a market, each firm’s actions influence the profits of all the other firms. When Penny Stafford opened her coffee shop in Bellevue, Washington, a nearby Starbucks coffee shop took a hit. Within days, Starbucks began to attract Penny’s customers with enticing offers and lower prices. Starbucks survived but Penny eventually went out of business. Penny Stafford and Starbucks were interdependent…”\(^\text{14}\)

This market also give a firm another advantages. The most cases happen is when firms in Oligopoly get together and tend to act like single large firm, a monopoly in order to boost their profit. Parkin (2003) says, “…When a small number of firms share a market, they can increase their profits by forming a cartel and acting like a monopoly. A cartel is a group of firms acting together—colluding—to limit output, raise price, and increase economic profit. Cartels are illegal, but they do operate in some markets. But for reasons that you’ll discover in this chapter, cartels tend to break down….”\(^\text{15}\)

Islamic Economic Theory really supports the freedom to entry the market. There’s no barrier to enter the market. Karim (2007) in his book said Islamics experts agree that force people to sell a stuff that not required to sell and to prevent people from selling a good that allowed to be sold, as an unfair thing so considered as a violation to the law.\(^\text{16}\)

Further, Islamic Economic theory criticize the existence of collusion between the buyer and seller. Otherwise, agree with homogeneity and standardization of product, also prohibit imitate or adulteration of product and trickery packaging of product to sell.

\(^{13}\) Wayback Machine Video, Chapter 30 : Oligopoly.
\(^{15}\) Ibid
\(^{16}\) Karim, Adiwarman. *Ekonomi Mikro Islami* (Rajagrafindo Persada) 147
In Islamic economic concept, the determination of the price are picked by the market, its mean how big the power of supply and demand, and the meet of demand and supply based on taraadheen\textsuperscript{17}, there is no one feel forced to make the transaction at this price rate.

The taraadheen\textsuperscript{18} condition is the opposite of oppression circumstance, where the one side is happy or satisfied with the other side sadness and trouble. In the case of pricing, the Fiqh Experts\textsuperscript{19} formulate it as the price of equivalent\textsuperscript{20}. The price of equivalent concept has an important implication in economics theory that is competitive market condition.

In addition, way of Islamic economics in control of the price is determined by the causes. If the cause is genuine demand and genuine supply change, the mechanism is to perform the market intervention. Whereas if the cause is distortion towards genuine demand and genuine supply, the mechanism is removal the distortion including perform price intervention to restore the price before the distortion.\textsuperscript{21}

The market intervention has happened in Rasulullah S.A.W and his Caliphate time. There was an increasing in wheat price in Madinah, so the government making the decision to import the wheat from Egypt.

For the price intervention, Islam allowed and even obligate in order to protect the buyer’s and seller’s right if the price is increased caused by distortion of genuine demand and genuine supply. Even the khulafa’ ur rasyideen\textsuperscript{22} did the price intervention. It happened when Umar bin Khattab r.a come to one of market and found Habib bin Abi Balta’ sells raisins with lower price from the market price rate. Umar bin Khattab r.a instantly reprimand him and say “increase your price, or leave our market.”\textsuperscript{23}

\textsuperscript{17} Arabic, means no one feel forced otherwise they are happy and conscience.
\textsuperscript{18} Arabic, means no one feel forced otherwise they are happy and conscience.
\textsuperscript{19} Mean the experts in the Islamic law. Also called as Fuqaha.
\textsuperscript{20} “O ye who believe! Eat not up your property among yourselves in vanities: But let there be amongst you Traffic and trade by mutual good-will: Nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful!” (Al-Qur’an Al-Kareem 4:29)
\textsuperscript{21} This is Ibn Taimiyah opinion, Al-Hisbah, (Cairo: darul Sya’b, 1976) sourced from Karim, Adiwarman. \textit{Ekonomi Mikro Islami} (Rajagrafindo Persada) 154
\textsuperscript{22} The Four Islamic famous leader after Rasulullah S.A.W
\textsuperscript{23} More further please look Abdullah Ali Hasan (1986), \textit{Sales and Contracts in Early Islamic Commercial Law}. PhD dissertation submitted to University of Edinburg, page 50. Needs to know that economic concept applicable at that time is Islamic Economics Concept which accord to price of the equivalent concept, which automatically picked in competitive market structure. In competitive market, selling the goods below the market price is predatory pricing strategy (to sells the goods even for the loss so other competitors leave the market and further increasing the price for above the normal rate), where anyone who holds stronger capital
To still the stabilization in the market, government should do everything as not violating *mashalih lil Jami’*. As example, in case austerity of primer needs, government are able to make a force to the seller which hoarding the goods to sell their goods. If the purchasing power from the society is weak, the government can buy those primer needs using baitul maal’s funds for make a deferment pay sales for the society as Umar bin Khattab r.a did. In case baitul maal has lack of funds, government can ask the rich to give their contribution more.

Among the causes of permissibility are:

a. Price intervention is related with society rights, which mean protect both the sellers in profit margin and the customers in purchasing power.

b. If there’s no price intervention, the sellers has a room to increasing their prices using *ihtikar*\(^{24}\) or *ghaban faahisy*\(^{25}\). In this case, the sellers violating the customers rights.

c. The customers usually represent the wider community, while the sellers represent a smaller of community groups.

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\(^{24}\) Arabic, means Monopolizing or hoarding the goods

\(^{25}\) Arabic, means the sellers obscure the information to the customers
5. Conclusion

For the conclusion, after the enlightening the definition of Oligopoly market in Conventional views and enlighten how Islam manage the market, and make comparison between that concepts theories, I would like to let you thinking and choose the best system and concept to reach the gloriousness.

As we compared before, the conventional one or named with capitalism, which declared the best economic theory and concept, also bring the happiness and justice for both sellers and customers. But in facts, there’s too many people suffering caused by this system or model of economic. Because this economics theory which give the advantages more for the rich and give the disadvantages more for the poor. People become homeless and loss everything, different with the rich which taking everything from them. As results, capitalist headquarter in Wall Street being occupied by the force of people.

Different with Islamic one, this economic theory give the justice and bring the happiness for people, and its rules guiding the community to reach the gloriousness. The wealth spread perfectly, no one has a very huge amount of wealth, and there’s no one being real very serious poor. Also this economics theory has tested before, when monetary crisis happen in 1998 in Indonesia, there are too many bank and firm collapse, meantime as we can see there is Syariah bank can survive this economic disaster.

In this conclusion, I also will give my opinion about this comparison. What can I say is, the conventional economic theories are gives the advantages more to the firm than the customers and this matter causes unstable circumstance to the market. This is what the conventional or we can say it capitalist economic principle. Different with the conventional one, Islamic Economics theory honor the stabilization and justice to the market.

So, Islamic economics against excessive terms when the market power freely working to pick it is competitive price. -With an attention to flaw competition market- if the seller stock pile the goods then sell it above the normal price meantime the people in needs to that good, so the seller are forced to sell it in equivalent price rate. And then, if there’s an elements of monopoly –especially in primary needs market- the Government must get involved to prevent the monopoly’s power.
Reference:


The Holy Quran, English translation.

Wayback Machine Video, *Chapter 30: Oligopoly*