



# An Introduction to the Economics of Competition

by

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# *Aims*

- ❖ To show that there are complexities in our understanding of the relevant market for competition purposes and
- ❖ That there are a number of competing perspectives in industrial economics which make public policy decisions problematic.



# *Learning Outcomes*

- ❖ After following this paper you will be able to
- ❖ define industrial economics
- ❖ demonstrate what a concentration ratio is
- ❖ assess the definition of an industry
- ❖ compare and contrast various perspectives in industrial economics



# What is industrial economics?

- ❖ Industrial economics is the application of microeconomic theory to the analysis of firms, markets and industries (Stigler, 1968)



# The concept of an industry

- ❖ The term 'industry' refers to the aggregation of firm numbers at some politically determined level: the region, the nation, the EU.

This aggregation could be based on

- ❖ demand side (market based) criteria
- ❖ supply side (technology based) criteria



Table 1

Standard Industrial Classification - 1992 Revision

SIC92

92sect	92div	92group	92class	92subcl	description
4					<b>D: Manufacturing</b>
	15				Manufacture of food products and beverages
		151			Production, processing and preserving of meat and meat products
			1511		Production and preserving of meat
				15111	Slaughtering of animals other than poultry and rabbits



# Why is the concept of an industry important?

- ❖ Koutsoyiannis (1979) argues that the concept of an industry
- ❖ reduces complex inter-relationships of all firms in an economy to manageable dimensions
- ❖ makes it possible to derive a set of general rules from which we can predict the behaviour of competing groups that constitute an industry.
- ❖ provides a framework for the analysis of entry on the behaviour of firms and on equilibrium, price and output.



# Oligopoly

- ❖ “Competition among the few” W. J. Fellner (1949)
- ❖ Duopoly: where two firms produce industry output.



# Measuring Oligopoly

- ❖ ‘Tight’ Oligopolies and
- ❖ ‘Loose’ Oligopolies
  
- ❖ Concentration Ratio
- ❖ **The Hirschman-Herfindahl index**



**Table 3**

**Accounting for imports in Concentration Ratios – The UK Car industry**

<b><u>Year</u></b>	<b><u><math>(Y5i - M5i) / (Yi + Mi)</math></u></b>	<b><u><math>Y5i / (Yi + Mi)</math></u></b>
<b>1965</b>	<b>91.35</b>	<b>91.40</b>
<b>1975</b>	<b>74.20</b>	<b>66.60</b>
<b>1985</b>	<b>72.40</b>	<b>41.80</b>
<b>1994</b>	<b>69.76</b>	<b>40.99</b>

**Source: adapted from Cowling et al (2000) Table 1 p.49.**

<b><u>Firms</u></b>	<b><u>Mkt Shares</u></b>	<b><u>4 FirmCR</u></b>	<b><u>HH</u></b>
<b>Ten firms</b>	<b>10%</b>	<b>40</b>	<b>1,000</b>
<b>Six firms</b>	<b>16%</b>	<b>64</b>	<b>1,667</b>
<b>Five firms</b>	<b>20%</b>	<b>80</b>	<b>2,000</b>
<b>Four firms</b>	<b>25%</b>	<b>100</b>	<b>2,500</b>
<b>Three firms</b>	<b>33%</b>	<b>100</b>	<b>3,333</b>

# Perspectives in Economics



# Structure - Conduct - Performance

- ❖ Viewing industries in this way suggests that public policy may be applicable.



# *Basic Conditions*

- ❖ To understand an industry structure and the conduct within it is necessary to know
- ❖ the demand and supply side factors that influence the industry.
- ❖ the regulatory framework within which organisations have to operate
- ❖ For example, an industry may only be able to sustain 5 firms operating efficiently because of the cost and technology conditions that currently prevail. Or, the Government may grant a monopoly right to provide a particular product, e.g. Camelot who run the National Lottery.



# *What is structure?*

- ❖ Describes the characteristics and composition of markets and industries in the economy.
- ❖ Refers to the number and size distribution of firms in the market.
- ❖ And the ease of entry into (and exit from) the market



# *What is conduct?*

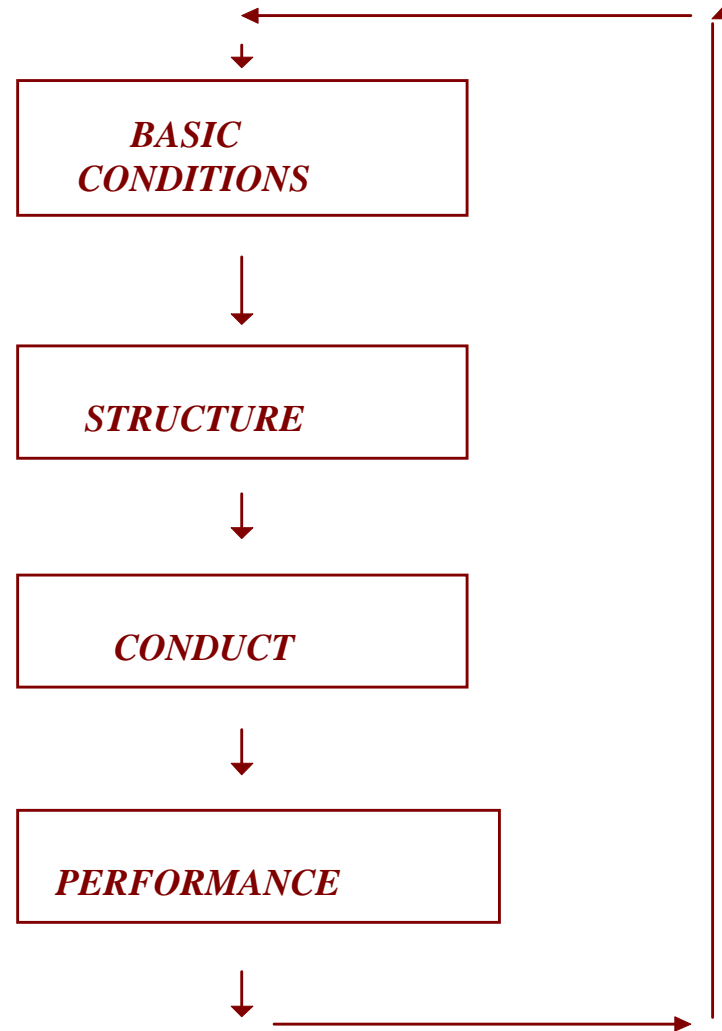
- ❖ Refers to the behaviour (actions) of firms in a market; the decisions they make and also the way in which these decisions are taken.



# *What is meant by performance?*

- ❖ Do the firms enhance economic welfare?
- ❖ Are they being productively efficient, avoiding wasteful use of available factors?
- ❖ Are they being allocatively efficient in producing the right goods in the right quantities?
- ❖ How effective are they in enhancing employment and economic growth?





**Figure 1: The Traditional Structure -  
Conduct - Performance Approach**



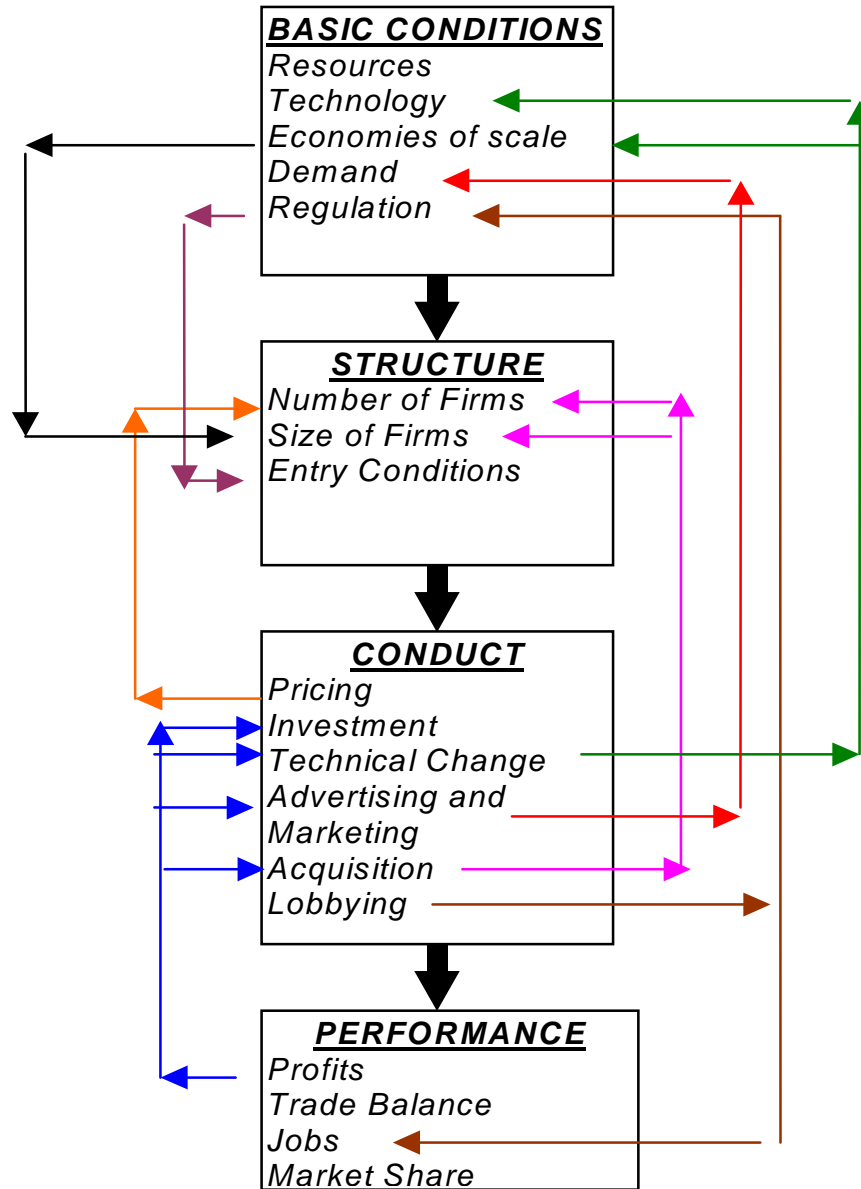


Figure 2  
The S-C-P Paradigm. A more complex view



# Other Perspectives of Industry

- ❖ Behaviourists
- ❖ New IO
- ❖ UCLA Chicago School
- ❖ Contestable Markets
- ❖ Austrian View



# Have you covered the learning outcomes?

- ❖ Consider the following (without reference to the paper)
  - ◆ What is meant by the term industrial economics?
  - ◆ What is the Herfindahl-Hirschmann Index of concentration and how does it compare with the n-firm concentration ratio?
  - ◆ What factors should we take into account when defining an industry?
  - ◆ Briefly (less than 100 words) consider whether a particular structure leads to a certain performance or is more complex than that?



# And Finally....

- ❖ A summary
- ❖ Have you covered the learning outcomes?
- ❖ Any questions?

