Competition policy

The Economics of Regulation and Competition

Dr. Tunç Durmaz
Econ. Dept. - Yildiz Technical University

17.05.2018

Intelligent government regulation

- In a market economy, the state is at the heart of economic life.
- How? Ideally through…
  - Public procurement: the state/government is a buyer and therefore organizes competition between suppliers for
    - Construction of public buildings
    - Transport (highways, railroads, and mass transit in cities)
    - Hospitals / Defense / Other government activities
  - The state is the legislative and executive power
    - It gives permission to
      - Open supermarkets/ Issue taxi licenses / Grants land rights to airlines
    - It licenses spectrum to telecommunications, radio and television operators
    - Note that the government's legislative and executive power directly influences the prices consumers pay for
      - Shopping
      - Travel
      - Phone calls
      - Favorite programs

Intelligent government regulation

- In a market economy, the state is at the heart of economic life
  - Public procurement (satin alma): the state/government is a buyer and therefore organizes competition between suppliers for
  - Legislative and executive power
  - Referee of market
    - The government encourages competition, which guarantees innovation and affordable prices
      - It sets the rules through competition law, works through competition authorities to prevent abuses of dominant position
      - Prohibits agreements and mergers that would cause prices to rise too much.
  - Regulator of Sectors (e.g., telecommunications, electricity, postal service, railroads…)
    - The state ensures that monopolies or highly concentrated markets do not exploit users

Intelligent government regulation

- In a market economy, the state is at the heart of economic life
  - Public procurement (satin alma): the state/government is a buyer and therefore organizes competition between suppliers for
  - Legislative and executive power
  - Referee of market
  - Regulator of Sectors (e.g., telecommunications, electricity, postal service, railroads…)
  - Financial Supervisor
    - Ensures that banks and insurance companies do not take too many risks to increase their profit at the expense of savers -or tax payers if the financial institution has to be bailed out.
  - Signatory of international treaties
    - Regarding, in particular, world trade.
    - This role determines the exposure of sectors of the industry to foreign competition

Government regulation

- Yet, the state might not fulfil these functions properly because
  - it may be negligent
  - Or, more often, influence of strong organized lobbies
    - Rather than protect users or tax payers (majority but apathetic-kayıtsız), the state prefers to remain in good favor with the lobbies
- Special interest groups are particularly influential when it comes to restrictions/prohibitions on competition.
  - Surprising? From shareholders to employees, businesses want to block new competitors or get financial compensation from the government if they lose exlusive access to a particular market
  - It is more of a surprise to see that the state gives in to such demands
  - Who are the victims of this lack of competition?

Government regulation

- In every country, consumers and taxpayers have little influence compared to special interest lobbies
  - European legislation
    - Pan-European competition rules and other regulations governing economic activity
    - These rules made it possible for many countries to modernize their economies by protecting their politicians from the power of interest groups
- A striking example is the diverging trajectories of Poland (as well as Estonia) and Ukraine
  - Similar economic levels before
  - Poland joins EU
    - EU competition law made it possible to prevent monopolies from forming when the economy was liberalized (Estonia went further with liberalizing its markets)
    - Partly, because of political corruption, the opposite happened in Ukraine

What is the purpose of competition policy?

- We, economists, praise the merits of competition.
  - But competition is rarely perfect (market power)
- Advocates of competition, as well as its detractors, sometimes forget that competition is not an end in itself
  - If competition leads to inefficiency, it must be eliminated or corrected
- But how does competition serve the society?

How does competition serve the society?

- There are three main benefits
  - Affordability
  - Innovation and efficiency
  - Integrity

How does competition serve the society?

- Affordability
  - Lower prices for consumers – the most obvious benefit!
  - Consider a monopoly/cartel: It can increase its prices and will only lose a few of its customers
    - This would hold for a dominant company
      - Private and seeking profit
      - Public and most often seeking revenues to cover high production costs
    - The would cause people to have less purchasing power and consume less
  - The entry of competitors puts downward the pressure on prices and makes consumers less captive
  - Examples?

How does competition serve the society?

- Affordability: Examples
  - Taxi industry in France
    - High prices
    - Poor-quality service
    - Shortage of available vehicles
  - The entry of Uber (although controversial, like it is in Turkey) has increased competition
  - The airline deregulation in Turkey
    - 1983: The first part of the deregulation gave private enterprises to establish airlines and airport operators
    - 2003: The second one gave rights to airline companies to operate domestic routes independently.
    - <u>What has happened since 2003?</u>

How does competition serve the society?

- Affordability: Examples
  - Cell phone or the Internet in African countries
    - Competition between companies has provided more affordable telecommunications
    - This is also the case in Turkey and most of the developed countries
  - An example of the adverse effects of restricting competition
    - France's Raffarin and Galland Laws of 1996
      - The Raffarin Law made it illegal to open a new supermarket of more than 300m^2 without government authorization.
        - This law was supposed to restrain the power of large supermarkets but immediately the value of shares in the big chains went up!
        - The opening of large supermarkets was blocked for 10 years
      - The Galland Law banned supermarkets from passing on to consumers the price reductions
        - This led to supermarkets to stop discounting
      - Who loses? Who gains?

How does competition serve the society?

- Affordability: Final examples
  - Protection against international competition
    - Opening up the European market to competition from imports drastically changed the organization of the automobile industries and productivity
      - France; Renault and Peuget-Citroen sharply increased their efficiencies
  - China's accession to the WTO in 2001
    - Following this there was a sharp increase in innovation and productivity in textile companies threatened by the Chinese competition
- The effects are not negligible for consumers

How does competition serve the society?

- Innovation and Efficiency
  - Competition
    - encourages businesses to produce more efficiently and innovate.
    - Promotes a diversity of approaches and experiments, giving rise to new technologies and business models, as we can see ONLINE
  - Productivity gains can be broken down into
    - Gains in existing businesses
      - Which improve when spurred by competition
    - Gains through creative destruction
      - When inefficient enterprises disappear and are replaced by more productive startups.
      - In the US and in France, at least a quarter of the productivity growth is estimated to be attributed to this

How does competition serve the society?

- Innovation and Efficiency
  - We already know that lack of competition makes life easy for companies, their executives and employees, who enjoy the tranquility in a protected market
    - Monopoly rents!
  - But monopolies
    - Tend to have high costs
    - Usually generate little innovation
      - They really don't need to innovate because the executives face no criticism in the absence of competition

How does competition serve the society?

- Innovation and Efficiency
  - Innovation in products and customer service are not simply due to extraordinary technical advances.
    - Taxi example: Uber, SnapCar, Lyft, and others using a mobile app to link drivers and passengers
      - Have introduced simple ideas for which users are voting overwhelmingly with their feet and wallets
      - Geolocation makes it possible to follow the driver's route to the destination and work out how long it will take to arrive. This traceability protects the consumer
      - Paying with a preregistered debit card using an app that sends an electronic receipt direct to the user simplifies the payment process and makes it easier for business travelers to reclaim their expenses.
      - Another innovation: Feedback. It allows drivers and users to build a reputation for courtesy and punctuality.
        - Providing a bottle of water or letting passengers recharge their cell phone are hardly technologically revolutionary.
      - However, taxi companies had either never thought of these innovations or just did not bother to introduce them.

How does competition serve the society?

- Integrity
  - When there is competition, companies cannot obtain monopoly rents through government regulations. Therefore, they do not spend large sums on rent seeking
    - Recall: rent seeking imposes costs on society because they are not productive and lead to monopoly rents due to the privileges they lead to
  - Corruption represents the extreme quest for rents
    - Import controls in developing countries
      - Licenses are granted by government officials who have powerful friends and enrich themselves at the expense of everyone else.
      - <u>If the goal is to limit imports,</u> better too
        - levy a tax
        - Allocate quotas to the highest bidder (***competition***) through a government auction, whose revenues would go to the state