The Effectiveness of Competition Policy and the Price-Cost Margin: New Econometric Evidence

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Comments Welcome – the usual disclaimer applies

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Introduction and Background

• Surge of interest in competition policy:
  – Reflects advances in economic research (IO and econometrics)
  – Economic policy more supply-side and microeconomic
  – Lawyer-economist interface – legal tests, economic analysis
  – Emphasis on coherent arguments, evidence-based analyses
Purpose of the Paper

- Despite the heightened emphasis and awareness of competition policy (by governments and among businesses), economic researchers have given relatively little attention to analysis of the effectiveness of competition policy – is it fulfilling its objective of curtailing the exercise of market power?

- This paper presents new econometric evidence relating the price-cost margin to a range of possible determinants, including a variable capturing independent assessment of NCA quality, which we adopt as a measure of competition policy effectiveness.
Data

• ‘Panel data’ of 19 markets in the same number of countries during 1999-2003

• Dependent variable: market price-cost margin

• Independent or ‘explanatory’ variables include: (1) market growth, (2) import penetration, (3) spare capacity and (4) a measure of the effectiveness of a country’s competition policy

• The latter explanatory variable captured using the Global Competition Review (GCR) annual ratings of NCAs
Data

• Advantages of the GCR variable:
  – Independent
  – Accurate – reflects ‘hard’, objective data and widely accepted as the position
  – Succinct (embodies a large range of factors)
  – Most detailed and comprehensive of its kind available
  – Proxy for competition policy effectiveness owing to the primary role played by NCAs in enforcing competition policy

• Important to control for other variables as well as competition policy effectiveness
Methodology

• Econometric specification:

\[ PCM = f(GCR, M\text{growth}, \text{Impen}, \text{Spcap}; u) \]

• \textit{GCR} (–ve, central hypothesis of the paper)
• \textit{M\text{growth}} (+ve/-ve)
• \textit{Impen} (-ve) (reflecting some but not all previous studies)
• \textit{Spcap} (-ve) (competition studies – e.g. merger review)
GCR Scores 2003

- US: 4.5
- Germany: 4.25
- UK: 4
- Netherlands: 4
- Italy: 4
- France: 4
- Canada: 3.75
- Sweden: 3.5
- Spain: 3.5
- Finland: 3.5
- Denmark: 3.5
- South Korea: 3
- Japan: 3
- Austria: 3
- Norway: 2.75
- Mexico: 2.75
- Greece: 1.5
### GCR Scores 2003 & 2006

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Results – Econometric Model 1

• Well-determined specification – over 90% of variation in **PCM** explained
• Industry-specific and country-specific effects captured in fixed effects specification
• **GCR** variable negative and statistically significant
• Other statistically significant variables:
  – **Mgrowth** (+ve)
  – **Spcap** (-ve)
• Import penetration not significant
• No evidence of lagged effects in **GCR** variable
Results – Econometric Model 2

• Again, a well-determined specification – over 90% of variation in PCM explained
• Industry-specific and country-specific effects again captured in fixed effects specification
• GCR variable negative and statistically significant
• Other statistically significant variables:
  – Mgrowth (+ve)
• Spare capacity and import penetration not significant
Conclusions

• More effective competition policy associated with lower price-cost margins, controlling for other factors

• Government should adhere to facilitating effective competition policy as an instrument of supply-side reform and economic efficiency – *for many, competition is the best means of ensuring long-run enhancement of productivity, innovation and competitiveness*

• Effective competition policy – therefore effective NCAs – important in facilitating the competitive process