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The dynamics of industrial mark-ups in two small open economies: does national competition policy matter?

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Abstract

In this paper we investigate the impact of competition policy on the level and the dynamics of firm price cost margins in two European countries, Belgium and the Netherlands. We study three questions: (i) Did the changes in the competition law and policy that took place in Belgium in 1993 have an effect on the level and the evolution of the price–cost margins of firms? (ii) Are price mark-ups in the Netherlands, where there was no strict competition policy until recently, higher than in Belgium? (iii) Is openness (import competition) sufficient to discipline firm behaviour? We find that the introduction of a new competition policy in Belgium did not have any effect on the price mark-ups in Belgium. We also find that mark-ups in the Netherlands are higher than those in Belgium. Finally we find that import competition does not lead to lower price cost margins. We offer a number of explanations and implications.

Keywords: Competition policy; Mark-up; Import penetration

JEL classification: C23; K21; L13; L4

1. Introduction

Competitive pressure is generally seen as a good thing in economics, since it reduces monopoly power and forces firms to organise production more efficiently.

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Welfare increases when markets become more competitive, and hence governments have an interest in establishing and maintaining competitive product markets. As such an antitrust legislation has been implemented in the US since 1890. For more than a century, the Department of Justice and later on the Federal Trade Commission have investigated a countless number of cases, the most recent one being the case against Microsoft.[1]

On the contrary most European countries adopted competition laws only after World War II. Moreover these were not applied coherently, except perhaps in Germany and in the UK.[2] Parallel to these, the founding Treaty of the European Community has included tough antitrust rules against agreements between firms (Art. 85) and against the abuse of a dominant position (Art. 86). Under these rules, most attention has been given to agreements and abuses that had cross-border implications, for example firms that were blocking imports into their country. Within countries, the enforcement of antitrust rules was rather disparate. With the Maastricht Treaty, subsidiarity as a principle was also implemented within this area of policy making. Therefore, countries that were lagging behind have recently brought their legislation closer to European standards.

In this paper we investigate the impact of competition policy on the level and the dynamics of firm price cost margins in two European countries, Belgium and the Netherlands. Both are small open economies with very similar economic characteristics. However, in 1993, Belgium adopted a new antitrust legislation very similar to the European one, while the Netherlands continued the implementation of their antitrust law dating from the fifties until January 1998.

The effect of competition policy on firm behaviour should be approached from a dynamic perspective, rather than a static one, because the competitive process is itself dynamic. We will focus on the evolution and the level of price mark-ups of firms as suggested by the recent work of Sutton (1991): Equilibrium prices (P) or mark-ups are a declining function of the number of firms (n) in the market, however, the slope may differ depending on the degree of competition in the market. In one extreme case, tacit collusion, $P(n)$ is a flat line, i.e. when a new firm enters the market equilibrium prices are not affected. This is the situation in which firms face very weak price competition. The other extreme case is the one of Bertrand competition where prices fall to marginal costs once a second firm enters the market. This is referred to as the extreme case of very tough price competition. All other oligopoly models will have associated $P(n)$ functions that lie between these two extreme cases. While the strategic interactions between firms can affect the position and the slope of the $P(n)$ function also a number of exogenous

[1] The reader is referred to Comanor (1990) for a review of the role of antitrust in the US; for an historical perspective see Mueller (1996), and for a description of the application by antitrust authorities of recent development in antitrust economics see Baker (1999).

[2] See Symeonidis (1998) and Neumann (1998).