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Competition Policy and Development

Entrepreneurship, access policy and economic development: Lessons from industrial organization

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Abstract

This paper explores some relationships between promotion of competition and economic development that arise from the impacts of entrepreneurial firms. In this respect, two sets of policies are critical for furthering economic development. First, to arrest the diversion of entrepreneurial talent towards non-productive activities, an increased emphasis on preserving rewards from productive innovation is needed – through the protection of commercial freedom, property rights and contracts. Second, given that essential local inputs are vulnerable to monopolization and foreclosure, fostering opportunities for grass-roots entrepreneurship becomes paramount – through a more activist supply-side competition policy emphasizing access to essential business services and other required local inputs. A key message is that the conventional sensitivity of policy concerns about the social welfare effects of foreclosure should be extended to a domain beyond the usual essential facilities of public utilities. It should include access to many other elements of the business infrastructure that are taken for granted in mature market economies, but that pose real barriers to productive entrepreneurship at the grass-roots level in the context of development. Additions to the incipient empirical work in this area could yield substantial policy dividends. © 2000 Elsevier Science B.V. All rights reserved.

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1. Entrepreneurship, access policy and economic development

How important the promotion of competition is in the context of a developing or transition economy as compared to more advanced market economies, and what is the most appropriate policy mix to promote competition are important policy questions. In a recent review of the possible transmission channels between competition and enterprise growth, Rey (1997) discusses how enhanced rivalry can spur innovation of profit-maximizing firms as well as various ways in which competition can act as a disciplining device inducing managers to adhere more closely to profit maximization.[1] A key difference between developing and more mature market economies is that internal agency costs are likely to be much higher in managerial firms, due to more pronounced informational asymmetries in credit and product markets, more significant contract enforcement problems, and weaker relevant institutions. In this context, an increase in competition may have a particularly favorable impact on growth when firms face important agency costs. In particular, Aghion et al. (1999) show that when agency problems become particularly severe, as when the need for outside finance becomes so high that investors are reluctant to lend, more competition can lead to higher investment or other credible forms of commitment to raise effort. Based on enterprise-level data, Nickell et al. (1997) show that product market competition can act as a substitute for debt-related financial pressure and external shareholder control.

In this paper, we further explore the nexus between competition and economic development by focusing on owner-managed entrepreneurial firms, where the traditional agency problems between financiers and managers are less severe. Entrepreneurial activity is linked to the creation of productive jobs, new output and new demand for inputs of all kinds.[2] Moreover, introduction of new products appears to have a bigger impact on overall welfare than the increased consumption of existing products.[3] On the theoretical side, we link

[1] On the former, see Aghion et al. (1995); on the latter, see Meyer and Vickers (1997) on benchmarking, Hart (1983) on pressure of entrepreneurial on managerial firms, Willig (1987) on pressure of owners on managers, and Schmidt (1997) on pressure of banks on managers.

[2] The relative ease of new entry and expansion by entrepreneurial firms in the US in contrast to Europe could be a leading explanation for the relatively higher rate of job creation in the US. See Krueger and Pischke (1997).

[3] See Romer (1994).