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Competition Policy in Transition: Theory, Implementation, and Challenges

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Course objectives

The objective of this course is to provide the economic tools needed for the analysis of competition, competition legislation, and alternative competition policy decisions. It will assist younger and prospective university lecturers in their effort to master state-of-the-art teaching in economics and to make use of the mainstream toolkit in the field. Furthermore, it will support independent competition analysts in their work to deliver the economic expertise necessary for the growing political debate, legal disputes, and administrative decision-making processes concerning market power and antitrust, mergers and acquisitions, state subsidisation, etc., that are now underway in all transition countries. As a blend of positive and normative analysis of competition, the course will cover the multifaceted aspects of the theory and draw inferences for policy implementation. The analyses and assessments of competition policies and their implementation will focus on the workings of competition on market efficiency and social welfare.

Target audience

The course is aimed at two groups of professionals: academics and competition practitioners. The economics of competition is increasingly finding its way into university curricula all across CEE and FSU: either as a stand-alone course, or as a growing 'competition' component in a variety of related courses, such as applied microeconomics, industrial organisation, law and economics, regulation, etc. Therefore, the course is primarily intended to assist young university lecturers, assistant professors, advanced postgraduate students and other scholars who are teaching or planning to teach such subjects at their home universities and institutes.

Competition practitioners in governmental agencies, NGO, and private consultancy firms are usually economists and lawyers; this course is planned for the economists among them. While lawyers are also welcome to apply, they will be expected to have already acquired a solid background in economics, and to indicate this in their application.

Course level & prerequisites

The course will be offered at a good upper-intermediate level. The only economics prerequisite is intermediate microeconomics, roughly at the level of the popular textbook of Hal Varian "Intermediate Microeconomics" (W.W.Norton & Co.), which has been translated in several transition countries.

Previous exposure of the candidates to industrial economics will be a distinct advantage. Condensed refresher of the relevant economic theory needed for this course will be included in the preliminary reader that will be distributed to successful applicants.

As for the mathematical prerequisites, to fully appreciate the course candidates should know at least the rudiments of multivariate calculus and basic statistics. Ideally, but not necessarily, some acquaintance with non-cooperative game theory would also be desirable. In the theoretical part of the course, models will be introduced with the language of mathematics yet also explained verbally. Computer lab exercises – to demonstrate the use of quantitative techniques in competition analysis – will require understanding the meaning of summary statistics and simple regressions. An effort will be made to keep mathematical explanations as simple as possible and everybody with 1-2 terms each of calculus and statistics should feel comfortable with all models.

In its core, the course is planned to be intelligible for all participants with basic knowledge of intermediate microeconomics. Conditional on funding, optional sessions may be offered to distinguish between more theoretically- and policy-oriented participants. Applicants may also be asked to attend a preliminary distant learning module in microeconomics & game theory in April – May 2002 as a preparation for the course and a part of the selection procedure.

Yet most of the course will rely on narration and intuition, and extensive discussions on policy issues. Hence participants are expected to be willing to enter into a debate, and to be able to formulate and defend a viewpoint.

Tentative course syllabus:

Week One: Competition and technical efficiency

Lectures, tutorials, computer lab exercises
Jonathan Haskel, Jozef Konings, Todor Gradev

This module will focus on the interactions between competition, privatisation, and productivity growth in the economy. The role of competitive pressures in the market selection process will be juxtaposed to evidence emerging from alternative ownership structures and alternative levels of market concentration. In this respect, the module will look at the contribution of FDI to creating a competitive environment and generating technological spillovers to local firms. Other topics to be covered here include competition-related issues of growth accounting, productive and allocative efficiency, mechanism design and incentives, innovation and Schumpeterian growth, firm and job turnover in transition. Theory and measurement techniques will intertwine in aspects such as market power, productivity growth decompositions, and firm restructuring.

Special attention will be devoted to measurement problems of market power. One of the most difficult tasks competition authorities are faced with is exactly how to measure market power and to detect abuse of dominant position. Various recently developed methods of measurement will be illustrated with real cases drawn from companies located in Central and Eastern Europe.

This module will include several computer lab sessions with the statistical package STATA. These sessions will give the participants a flavour of the application of quantitative techniques to competition analysis and acquaint them with the use of company balance sheets in measuring market power and the contribution of competition to productivity growth. The aim of these exercises is to illustrate the different welfare effects of different levels of competition in a particular industry. Depending on the interest of participants in applied econometric work, these sessions may be extended into the second week with a subgroup of the course.

Week Two: Competition, market structure and market dynamics

Lectures, tutorials, role play
Paul Walsh, Maria Vagliasindi

The theme of the second week is the interplay between the process of competition and the organisation of the market. Notably, the question will be posed how this interplay affects the economy, the efficient allocation of resources, and social welfare. To point at some answers, the ‘invisible hand’ process of market selection will be collated with theory and evidence of strategic behaviour of the market players.

Starting with the traditional structure-conduct-performance hypothesis (Bain-Sylos) and its extensions, this module will move to models and applications of market dynamics focusing on entry and exit. It will discuss the applicability to transition of standard entry deterrence techniques of market incumbents like investment into spare capacity, limit pricing, predation, etc. It will also look at the institutional barriers to market exit, and at the beguiling omnipresence of soft budget constraints, which inhibit the market selection in transition. Special attention will be given to infrastructure regulation – static and dynamic – aimed at preventing abuse of dominant position in the sector, and at bringing about effective competition in the wider economy. Particularly, this module will take up the competitive regulation of traditional areas of “natural monopoly” in sectors of the infrastructure like telecommunications, where a strong case can be made that infusion of competition can remove bottlenecks and improve access to essential business services.

The module will also cover extensively the theory and evidence of evolution of market concentration (Sutton approach) and its relevance to the economies in transition in a pan-European context. This will include competition in markets with exogenous and endogenous sunk costs, horizontal and vertical product differentiation and their effects on the structure of markets of different size. A question to be poised here is what facts account for the fragmentation of some, and the concentration of other markets in transition, and what competition policy should be put in place to address this phenomenon. FDI will be looked at differently in this module, focusing on the role of R&D and advertising as devices to endogenize the sunk costs of entry, which often translate into practices of “unfair” competition to be scrutinised by competition authorities.

The practical work in this module will include case study presentations and role plays of participants on real competition cases reinforcing the theory presented.

Week Three: Competition and international trade

Lectures, tutorials, simulation game

Alf Vanags, Julian Lee, Yelena Kalyuzhnova

The strategic interactions between international trade and competition on the international oligopolistic marketplace will be the focus of the third week of the course. The theory of custom tariffs, antidumping, and preferential trade agreements will be presented in the light of their effects on distortion of competition and/or welfare enhancement. Questions to be raised in this module concern the optimal balance between competition policy and trade liberalisation in transition, the relationship between national competition policy and terms-of-trade gains and losses, the effects of trade diversion in the years of transition on domestic product market competition, and whether *strategic* trade policies – e.g., import tariffs, export subsidies – serve the same role as *strategic* entry deterrence to a market.

Competitive considerations in inter-regional and intra-regional trade policies will be explored interactively on a simulation game of a meeting of the Energy Charter Secretariat, where a mock decision will be taken toward allocation of pipelines in the Caspian Sea region. After exposure to the economic and political consideration of the oil production and distribution in the region, participants will be divided into groups representing various interested parties and put in real bargaining positions.

Optional Sessions

Depending on the composition and interests of the group and the level of additional finance raised, the following optional sessions may be offered to all or some of the participants:

Oligopoly theory: a game-theoretical treatment.

Preliminary distant learning module (4-6 weeks).

The module will cover as a minimum: Cournot and Bertrand competition with homogeneous & differentiated products; Stackelberg and sequential games, first mover advantages; explicit and tacit collusion, sustainability of cartels; Nash equilibrium in infinite horizon games, credibility and reputation; welfare effects of different market structures; various elasticities; signalling games; bargaining.

EU competition policy and the challenges of enlargement

This mini-module (2-3 sessions) will be offered primarily to representatives of the competition authorities of the EU candidate countries who attend the course. It will briefly bridge the EU competition legislation

and some of the economic concepts participants will have encountered on the course. For example, the EU treatment of collusion and market power will be matched with "*agreements between undertakings*" and "*concerted practices*" in Article 81 and "*abuse of dominant position*" in Article 82 of the EC Treaty. More importantly, a representative of DG Competition of the EU Commission will be invited again to elaborate on progress and problems of competition implementation in the candidate countries in the process of EU enlargement.

Antitrust in the information economy

Another mini-module (2-3 sessions) will address the needs of antitrust in information-related markets. Specifically, competition analysts in these markets will be alerted of (1) the systems and network effects which induce monopolisation and anticompetitive practices, (2) peculiarities of price-setting in these industries due to low marginal relative to average costs, (3) the features of software as a durable good, and (4) the implications for competition of the cooperative setting of standards. A session-debate on the economics of antitrust in the Microsoft case may conclude this module in a more argumentative spirit.

For more detailed biographies, updated course description, syllabus, reading lists please check **<http://www.ceu.hu/sun/sunindx.html>**

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