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COMPETITION AND POVERTY REDUCTION

Contribution from Korea

-- Session I --

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THE EFFECTS OF COMPETITION POLICY ON POVERTY REDUCTION

-- Korea --

1. Introduction

1. In general, competition policy does not directly aim at helping the poor. At the same time, we cannot claim that competition policy has no effect on the poor. In this article, we will sort the different effects into three categories according to policies that have the most impact on the poor.

2. The first example comes from the demand side of the product market. The poor, as consumers, can, more than most, enjoy the benefit of the low prices induced by competition. In some cases, the poor can become new participants in the market after the implementation of a competition policy, where they had previously been unable to do so because of high prices.

3. The second is from the supply side. The poor, as employees, can receive either a higher income or a lower income as a result of competition. A firm facing fierce competition may dismiss some of their extant employees. In many cases, it is unskilled labour—more often the poor—who are the main target of these layoffs. The increase in production accrued from a competition policy can also open the doors to new chances of employment for the unemployed poor.

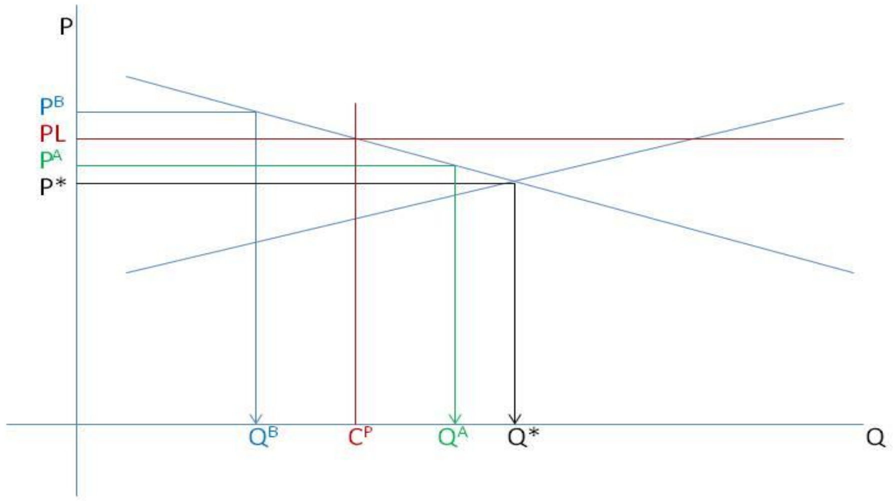
4. The third example comes from the international reallocation of resources. Competition policy may drive firms to other countries in order to avoid fierce competition or to lower production costs. The employees in the home country may then be dismissed, while those who are unemployed in the firm's target country may be newly employed. When we consider international interactions, the pattern of effects of a policy on the poor can be quite different across countries.

2. Category I: Lowered Prices Can Increase Consumer Surplus

5. Competition policy mainly aims to reduce market prices, and so increase consumer surplus. A well-designed competition policy can directly reduce market prices. When firms in the market collude taciturnly, they are possibly somewhere near the Cournot equilibrium. Sometimes, the policy breaks down a collusion and fierce price competition ensues (i.e. Bertrand equilibrium).

6. The figure below demonstrates how PB and QB are the market equilibrium price and quantity before the competition policy is implemented. If we suppose that there are no additional entry firms after the competition policy, and firms should decrease their prices because of the competition authority's effective monitoring for the taciturn (or explicit) collusion, then, the new equilibrium becomes (P*, QB).

7. In the aggregate, the consumer surplus then increases by QB(PB-P*). Looking at the figure below, we should assume that the consumers' willingness to pay for a product is related to their income levels in monotone, and that the PL is the maximum willingness that consumers below the poverty line can pay. In this case, no consumers below the poverty line can consume the product before the implementation of the competition policy. After the implementation of this policy, the poor have a chance to consume the product according to the allocation rule for over-demanded goods.



8. With this in mind, let's consider the case where a competition policy invites new entrant firms into the market. Even though the policy cannot monitor their taciturn (or explicit) collusion, the production will increase because of the increase in the number of operating firms. One possible result could be (PA, QA). At this new equilibrium, the aggregate consumer surplus increases by QB(PB-PA) + 0.5(PB-PA)(QA-QB). Moreover, the amount of (QA-CP) goes to consumers below the poverty line. That is, the newly obtained consumer surplus of 0.5(QA-CP) is attributed to the poor, who could not consume the product before the policy implementation.

9. With a necessity good, in contrast to a luxury good, the willingness to pay at the poverty line may be quite significant. In this case, even more poor can be included in consumption after the implementation of a policy.

10. When considering the poor as consumers for designated products, the effects of competition policy cannot necessarily lift the poor above the poverty line in nominal terms. This is largely due to a lack of consideration of the income of the poor. However, competition policy does have an effect on the poor in real terms. In other words, a decrease in prices can increase the poor's purchasing power in real terms, and so ultimately help the poor.

3. Category II: The Pressure of Competition to Re-organize the Production Process

11. One possible instant effect of the introduction of competition is to remove the extant inefficiency of production. Before developing a new technology and a new structure for a more efficient production scheme, each competing firm should reduce its own inefficiency. The layoff of surplus labour could be an answer. Some employees can be promoted to newly-created managing positions. Indeed, it is very difficult to determine what effect on the poor the removal of inefficiency might have. The employed poor can be dismissed while others might be promoted, in the same way that the unemployed poor can be employed.

12. With time firms faced with competition will develop new technology and new production schemes to increase production efficiency. New technology then induces a re-organisation of the production process. The re-organisation of employment is also an inevitable process. The effects on the poor would be similar to those mentioned above.

13. Firms can develop new products and new marketing strategies to avoid competition, with the effects similar to those already mentioned. The introduction of new products would lead to a need for more employment, which can open up new possibilities to the unemployed poor.

14. However, the most important effect of competition policy via the production process is the actual increase in what is produced and traded, both in terms of quantity and quality. In a homogenously "good" market, we can assume that competition policy increases the number of operating firms, and so increases what is produced and traded. Increased production would lead to a rise in the need for employment, including the unskilled labour often supplied by the poor. Employment can then increase a person's income level and allow him or her to rise above the poverty line.

15. Now, if we consider a monopolistic competitive market, a competition policy could lead firms to develop newly differentiated goods. Some firms may develop differentiated goods aimed at low-income consumers, while other firms may focus on high-income consumers to take advantage of their higher willingness to pay. Even though the lower-income consumers have less willingness to pay, it can nonetheless be profitable for firms when there is enough volume.

4. Category III: International Interaction Can Contribute to a Reduction in Worldwide Poverty

16. When the competition authority in one country initiates (or strengthens) competition policy, this policy can affect other countries. Firms operating in a competitive environment can consider moving into another country where there is a less competitive environment. Or, these firms can build new factories in countries with lower costs to reduce their production costs through lower labour costs.

17. It is most likely that the country with the more competitive environment and higher labour cost is the developed country and that the country with the less competitive environment and lower labour cost is the underdeveloped or developing country.

18. In many cases, dismissed workers in developed countries can avoid the fall into poverty since developed countries more often have a social safety net, with flexible labour markets that will allow unemployed workers to find a new job more easily. The new investment in the underdeveloped or developing countries can also create tremendous new employment opportunities for the unemployed poor. From the viewpoint of international interactions, therefore, the enhancement of competition policy in developed countries can help to reduce poverty worldwide.

5. Some Relevant Questions on the Effects of Competition Policy

19. When is price-reduction, caused by competition policy, more helpful for the poor than for the rich?

20. It seems quite obvious that the price-reduction from competition policy would be beneficial to all consumers, both the rich and the poor. Yet the extent or the effect of such benefits could vary depending on the elasticity of corresponding goods. More specifically, even a small drop in the price of goods that have a high price-elasticity of demand would dramatically expand market output so that a large number of people—including, the relatively poor—could participate in the market to consume such goods. On the other hand, a price that is lowered in a market with low price-elasticity may not be accompanied by an

increase in market output, so only existing consumers—more likely the relatively rich—would benefit from such prices, and not the poorer consumers. This might be a lesson for us on which product markets we should keep our eyes on and how to decide the priorities for the enforcement of competition policy.

21. Is it necessarily true that fierce competition between firms would give rise to the elimination of jobs for the poor in particular?

22. When firms face fierce competition, they have a stronger incentive to become more “efficient” through, for example, laying off “inefficient” workers. From the point of view firms (or the owners of firms), inefficient workers are defined as those who are paid more than their marginal productivity or their contribution to the firms’ merits. Given that higher-paid workers are more likely to be in such a situation, they would be the first to be laid off rather than lower-paid workers who are normally “underpaid.” Hence, incentives to lay off workers within firms may not be as detrimental to the poor as they are to the more well off.

23. Is competition law enforcement helpful for a small entrepreneur AND the poor?

24. Even if competition law enforcement is helpful for a small entrepreneur, it isn’t necessarily helpful for the poor, since there is no clear evidence indicating how small entrepreneurs are connected to the poor. Granted, workers hired by small entrepreneurs are paid less on average than those working for larger firms. However, a more thorough investigation of the numbers of low-paid employees working for small as opposed to large entrepreneurs should be carried out to measure the true effects.