MARKET POWER AND EFFICIENCY

Claude d'ASPREMONT, Alexis JACQUEMIN and
Jean JASKOLD GABSZEWICZ

Catholic University of Louvain, 1348 Louvain-la-Neuve, Belgium

The first special issue of the European Economic Review on 'Market Competition, Conflict and Collusion' (February 1981) offered a set of articles illustrating the growing interaction between different fields of research (imperfect competition, industrial organization and game theory) in the analysis of competitive processes. This second special issue focuses on a well-known but still very controversial topic, namely the respective roles of market power and efficiency in explaining the organization of industry. One view emphasizes the aspect arguing that major corporations are now organized in often interlinked oligopoly groups, in many cases with an international base, and have captured dominant positions which are relatively unassailable.[1]

The alternative view argues that, apart from those industries dominated by State Control, there is the strong presumption that the existing structure is 'the efficient structure'.[2] More specifically large firms are formed to capture technological and organizational efficiency.

To illuminate this controversy, it has seemed useful to us to denote the present issue of the EER to the topic of 'Market Power and Efficiency'.

The first four papers are concerned with the role of large multidivisional corporations. They exemplify much of the new scholarly work providing an economic analysis of the reasons why managerial hierarchies can replace market mechanisms for the coordination and allocation of resources in modern industrial activity.

The paper by Alfred Chandler shows how American industrial enterprises have increasingly relied on administrative efficiency rather than on the use of contractual cooperation to achieve market control. Such an evolution is compared with the Japanese and European experiences.

D. Encaoua and A. Jacquemin contrast two views on the role of industrial groups. On the one hand, the existence of these groups could allow for a

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[1] K. Cowling, in the February 1981 special issue of the EER.

[2] See J. McGee in H. Goldschmid, H. Mann and J. Weston, eds., *Industrial Concentration: The New Learning* (Little, Brown and Co., Boston, 1974).

greater degree of industrial concentration, leading to a higher price–cost margin; on the other hand, it could be a response to a search for an efficient form of organization. Using data on the French industrial groups, they test econometrically these two hypotheses.

In his paper A. Goto analyses the presence of business groups in the postwar Japanese economy. He discusses why the group mode of transactions can be relatively more efficient than the market mode and the pure internal organization mode, and tests econometrically some of the relevant aspects of his argument.

Using alternative game theoretical solution concepts, P. Kleindorfer and G. Knieps formalize the manner in which market power and transactions specific investments interact in the choice between vertical integration, long-term contracts and spot markets. They provide conditions where the cooperative solution implied by vertical integration coincides with the Nash bargaining solution representing long-term contracting.

The two following papers are concerned with how to relate industrial concentration indices and important components of a welfare analysis. From an axiomatic basis, C. Blackorby, D. Donaldson and J. Weymark provide a normative foundation for the notion of 'equivalent number of equal-sized firms', which is an inverse measure of concentration. They propose an overall preference ordering represented by an industry-performance-evaluation function depending on both the numbers-equivalent and the total industry output.

A. Dixit and N. Stern develop a unified sequence of models linking various magnitudes related to welfare, such as consumer surplus and profit, with observable magnitudes such as the size and concentration of the market. They extend their results to the analysis of oligopoly in international trade and of the operations of transnational companies.

In the last paper, P. Geroski is concerned with the discussion of the simultaneous equations model surrounding the basic profits concentration relationship. His econometric tests lead him to conclude that the model is non-linear in concentration and that simultaneous interaction occurs between profits and foreign competition variables.

We hope that this issue will contribute to an improvement in our understanding of the respective roles of market power and efficiency in the organization of industry.