

Analysing different theories of competition economics essay



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“ The nature of competition and its consequences on key economic variables, such as prices, profits, and growth, have always been important for theoretical and empirical investigation.” (Tsalik and Tsoulfidis, 1998, p. 187)

Many non-economist and even many economists use the term competition loosely to apply to markets that we refer to as non-competitive and some people use the term competition to refer to a market in which a few price-setting firms compete vigorously for sales. (Carlton and Perloff, 2005, p. 85)

Different terms of competition can be applied by the extent of market power.

As Ochoa and Glick argued, in comparing competing theories, it is difficult to single out the variables that represent each theory and one should begin by evaluating the most typical representation of each theory. (Blaug, 1978, p. 697)

First of all, the essay will present the standard neoclassical view of competition. In the next section, it will show the Austrian criticism of the standard theory. Then, turn to the Post-Keynesian criticism of the neoclassical theory of competition. Lastly, it will focus on the significance of the both criticism of the standard neoclassical view of competition.

Let's start with standard neoclassical theory of competition; generally speaking, neoclassical theorists who are the mainstream economists extended Smith's theory, classical theory, of a market system by formulating several conditions under which efficient resources allocation and an optimum level of social welfare would be realised. (Semmler, 1982, p 93) That is to

say, in neoclassical theory, there are largely two main concerns of the school of thought, which are utility maximisation and resource allocation.

Moreover, it is also believed that the mainstream microeconomics, neoclassical theory, considers the real world of markets, just as if observed phenomena characterise the fulfilment of equilibrium conditions.

According to Tsaliki and Tsoulfidis, (1998) competition is regarded as a position of equilibrium that would prevail if there would be free exit and entry of firms, in terms of neoclassical view of economics.

As Semmler indicated, in terms of neoclassical theory, the main conditions, necessary for a perfectly working competitive market system, are seen as: profit maximising producers and utility maximising consumers; a sufficiently large number of market agents; no externalities among their activities; and perfect mobility of resources between industries; and perfect foresight. (Semmler, 1982, p. 93)

As following the conditions we argued, it can assume that competitive procedures lead prices into equilibrium prices. As Semmler said, (1982) competition can lead disturbances eliminated and an optimal allocation of resources brought. Moreover, throughout the market system the existence of equilibrium prices are guaranteed. In this manner, both equilibrium and optimisation are regarded as distinctive features of neoclassical theory.

In short, under neoclassical theory, Tsaliki and Tsoulfidis stated that the intensity of competition generally depends on the number of sellers and

buyers on the market structure of an industry. (Tsaliki and Tsoulfidis, 1998, p. 188)

Therefore, firms' competitive behaviour is getting more effective as long as the number of firms in a specific industry is getting larger. As a result of this, Tsaliki and Tsoulfidis argued that competition produces an equilibrium set of prices that induce a Pareto optimal allocation of the economy's goods and services. (Tsaliki and Tsoulfidis, 1998, p. 188)

On the contrary, if the number of seller and buyer is getting smaller, the oligopolistic and monopolistic behaviour in the market is getting more and more. Consequently, some prices are above marginal cost and it is shown as underutilisation and underproduction even if they have available resources. It is called non-competitive equilibrium position.

For that reason, Tsaliki and Tsoulfidis argued that within the standard microeconomic theory of the firm, the persistence of profits in excess of normal is always associated with market imperfections, and therefore, with some degree of monopoly power. (Tsaliki and Tsoulfidis, 1998, p. 188)

Semmler believed that the features of standard theory need some qualifications, which is there are three main qualifications.

Firstly, one of the qualifications is quantity theory of competition. As it mentioned above, the intensity of competition in the market can be measured by the quantity theory of competition. It can mean that sufficiently large number of firms can lead to the optimum level closely. Next comes to one of the key assumptions is prices and quantities congregate on the way

to an equilibrium driven by competitive features. Lastly, the elimination of uncertainty, risk and expectation, is the third features of the neoclassical view of key assumptions.

Furthermore, in this theory, As Tsaliki and Tsoulfidis mentioned, firms are mainly seen as passive, that is-given the consumers' preferences and the technological opportunities-they merely react to parametrically given prices. (Tsaliki and Tsoulfidis, 1998, p. 188)

The work researched by Tsaliki and Tsoulfidis (1998) showed that the market structure of industries tends to be the core factor of neoclassical empirical studies with respect to observed interindustry profit rate differentials. Moreover, they believed that many neoclassical economists consider barriers to entry at least as equally significant as the degree of industry concentration.

According to Vaughn, he argued that the Austrian tradition is represented in modern economics by a ' very vocal, feisty and dedicated subset of the economics profession' (Vaughn, 1994, p. 11)

Generally speaking, the approaches researched by the Austrian writers have contributed to most primary problems of microeconomics, for sure.

According to Kirzner, the fundamental theory of Austrian approaches is the conviction that the standard neoclassical microeconomics, for which the Walrasian general equilibrium model (in its modern Arrow-Debreu incarnation) is the analytical core, fails to offer a satisfying theoretical framework for understanding what happens in market economies. (Kirzner, 1997, p. 61)

In terms of the Austrian approach, imperfect information can be decided as involving an element whilst it cannot be a part of neoclassical elements.

Modern Austrian theory can be discussed as several main factors, which play a significantly important role in Austrian theory. In the paper, we will focus on two significant element, entrepreneurship and equilibrium concepts to understand Austrian criticism of standard view.

The key point of the main factors in understanding the competitive process is entrepreneurship, the driving aspect in the Austrian theory. To understand entrepreneurial discovery approach needs to be aware of understanding actions, conditions and circumstances of entrepreneurs. Moreover, it is also pivotal to understand the nature of uncertainty. In the Austrian theory entrepreneurs always face uncertainties, which are pervasive and which are risks and fundamental uncertainties. Unlike the neoclassical theory, Austrian theory can be stated as unknowable due to the uncertainty. Nevertheless, it is not unimaginable because in Austrians the role of agents' imagination, which is an unknown idea in neoclassical theory, plays pivotal role to create the future.

According to Kirzner, the entrepreneurial discovery approach has echoed criticisms of equilibrium economics and have deployed criticisms in seeking to demote the concept of perfect competition from its position of dominance in modern neoclassical theory in order to replace it by notions of dynamic competition. (Kirzner, 1997, p. 64)

The entrepreneurial discovery approach has been affected by the work driven from Mises and from Hayek.

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In terms of Mises' view, he believed that the market is regarded as entrepreneurially driven process under Austrians. Moreover, Hayek focuses on the role of knowledge and its enhancement throughout the market interaction. For Mises, entrepreneurship is human action " seen from the aspect of the uncertainty inherent in every action" (Mises, 1949, p. 255) He, also, focus on the importance of entrepreneur who is always every actor in any real and living economy.

According to Kirzner (1997), each decision made by neoclassical theory is made within a without doubt known framework. Consequently, it has believed that in neoclassical idea, there is no specific role and opportunity for entrepreneurship differed from Austrian microtheory. It means that, simply speaking; there is nothing entrepreneur can do.

In this manner, it shows that " whereas each neoclassical decision market operated in a world of given price and output data, the Austrian entrepreneur operates to change price/output data." (Kirzner, 1997, p. 70)

Now, the essay will focus on the Austrian criticism of the equilibrium idea of the standard neoclassical theory.

As Kirzner (1997) mentioned " neoclassical economics operates on the assumption that the world reflects the relationships that would prevail in such equilibrium models - with the model of competitive equilibrium being the favourite one"

However, generally speaking, the Austrian approach disagrees and criticises this approach to understanding markets.

According to Kirzner (1997), he has believed that the Austrian theory is based on individuals whilst the neoclassical theory considers the individual decision as a mechanical exercise in constrained maximisation. Therefore, it has believed that the process of competition is open-ended for Austrians but not for neoclassical theorists.

As Kirzner (1997) argued, Within the neoclassical theory, the only explanatory means for understanding prices and outputs is to admit equilibrium theory. However, under Austrian concepts, it cannot be acceptable.

Post-Keynesian economics is essentially a response to the failures of neoclassical theory and its inadequate characterisation of economic activity. (Davis, 1987, p. 552)

Now, the essay will discuss the significance of Post-Keynesian criticism of the standard neoclassical view of competition.

“ Post-Keynesian economics has passed through the important initial change of mounting a concerted critique of mainstream economics” (Arestis, 1996, p. 11)

In terms of alternative theories of competition, Post -Keynesians are defined as two key factors; which are dominant firms and administered prices unlike neoclassical theory.

However, by and large, Post-Keynesians, who are a various set of economists, do not have generally accepted theory of competition.

Nevertheless, Kalecki, who set the main tradition of Post-Keynesian theory, <https://assignbuster.com/analysing-different-theories-of-competition-economics-essay/>

argued that the majority of Post-Keynesians maintain the above outlined classical cross-over dynamical process only for the primary sector of the economy characterised by a large number of producers, rigid supply in the short run, and flexible prices, which are 'demand determined' (Kalecki, 1969, p. 11) Moreover, uncertainty, is one of the most key factors of Post-Keynesians concern, is regarded as a reflection of real-world decision-making.

In terms of Lavoie's view, he indicated that Post-Keynesians have noted that oligopolies constitute their representative Post-Keynesian industry. They believed that oligopoly is the general state in most markets.

Under Post-Keynesian theory, prices are decided by dominant firms not by markets. In this manner, it has believed that prices are administered in accordance with firm's objectives, more particularly, prices of finished goods are set by a mark-up pricing on some measure of unit costs not by market clearing prices.

Lavoie argued that the issue of the domain of validity of the Post-Keynesian firm by saying that Post-Keynesians assert that there are hardly any markets where prices are not administered by firms. As a result, he indicated that most industries are to some extent imperfect or monopolistic markets, even those that at first sight might appear to be competitive. (Lavoie, M, 1992, p. 98)

Generally speaking, economic movements in real markets cannot fully explain by one specific theory. For example, according to Davis (1987), in the 1980s the number of individuals both in and outside economics has <https://assignbuster.com/analysing-different-theories-of-competition-economics-essay/>

come to perceive the world beset by economic crisis. However, orthodox neoclassical theory has been largely unresponsive to these developments. Therefore, we need alternative theory to response the problems such as Austrian theory and Post Keynesian theory.

We have focused on tree theory, which are standard neoclassical view, Austrian theory, and Post-Keynesian view of competition.

Austrian view of competition emphasises on the entrepreneurial rivalry to explain competition whilst Post-Keynesians are determined by dominant firms and administered prices theories.

The significance outcome we need to focus in the essay is to evaluate the relevance of the neoclassical orthodoxy, Post Keynesian, and Austrian theories of competition. Therefore, we can examine the appropriate way to contribute problems occurred.