

Economies of Scale and Imperfect Competition

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The constant returns, perfectly competition paradigm is endemic to most neoclassical economywide modeling. While this is a natural consequence of the latter's origins, a narrow structural and behavioral reference framework can limit the applicability of these models. This is particularly true for economies replete with market imperfections and institutional failure such as those in the developing world. In terms of market conduct, however, even within and between OECD countries a large proportion of economic activity is governed by less than perfectly competitive market forces.

As researchers have adapted classical CGE models to increase their policy relevance, economies of scale and imperfect competition have attracted interest for two reasons. Firstly, evidence from established and newly industrialized countries, particularly in Asia, indicates that the realization of scale economies can accelerate progress toward external competitiveness and domestic growth. Secondly, in the late 1980's and early 1990's trade economists "re-discovered" many ideas from industrial organization and applied them in thought-provoking ways.

Before a discussion of how these ideas have been applied by empirical modelers, it is worthwhile to remind ourselves about their practical significance. Trade theorists have been predicting for some time that these factors could exert significant influences on trade and development [References 4, 6, 10, 11, 12, 20, 22, 28, and 29], and these arguments have since been supported by an ever-expanding body of evidence outside [2, 13, 17] and inside [remaining references] the CGE literature. Thus we know these issues are policy relevant and empirically significant, but can we agree on standards for modeling them?

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Overview of Literature

The best general entry point for the literature on scale economies and imperfect competition for GE modeling is probably still de Melo and Tarr (1992), yet a very diverse set of approaches to these issues has arisen in the last decade. What follows is a list of issues relevant to the general discussion, accompanied by select references.

1. Scale Economies
[1, 9, 14, 15, 18, 21, 25, 26, 27]
2. Product Differentiation
[1, 3, 15, 19]
3. Price Setting
[5, 23, 24, 25, 27, 31]
4. Market Entry/Exit
[5, 23, 24, 25, 27, 31]
5. Regulation
[16, 31]
6. Other Issues
 - a. Market conduct
 - b. Productivity growth
 - c. Infrastructure
 - d. Transactions costs
 - e. Externalities

Selected References

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