The Economics of European Integration

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Chapter 6

Market Size and Scale Effects

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Market Size Matters

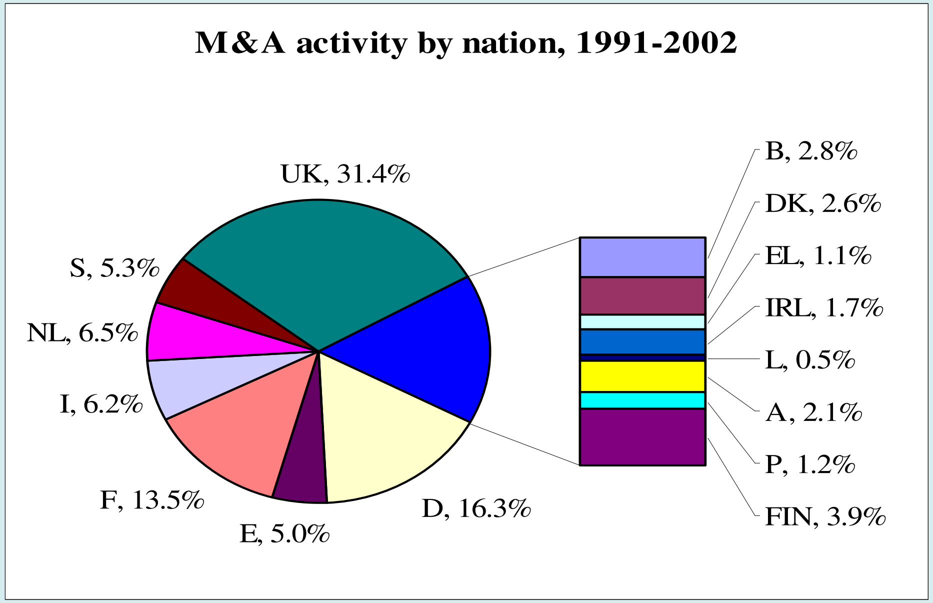
- European leaders always viewed integration as compensating small size of European nations.
  – Implicit assumption: market size good for economic performance.
- Facts: integration associated with mergers, acquisitions, etc.
  – In Europe and more generally, ‘globalisation.’

Facts

- M&A activity is high in EU.
- much M&A is mergers within member state.
  - about 55% ‘domestic.’
  - Remaining 45% split between:
    - one is non-EU firm (24%),
    - one firm was located in another EU nation (15%),
    - counterparty’s nationality was not identified (6%).

Facts

- Distribution of M&A quite varied:
  - Big 4: share M&As much lower than share of the EU GDP.
  - I, F, D 36% of the M&As, 59% GDP.
    - Except UK.
  - Small members have disproportionate share of M&A.



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Facts

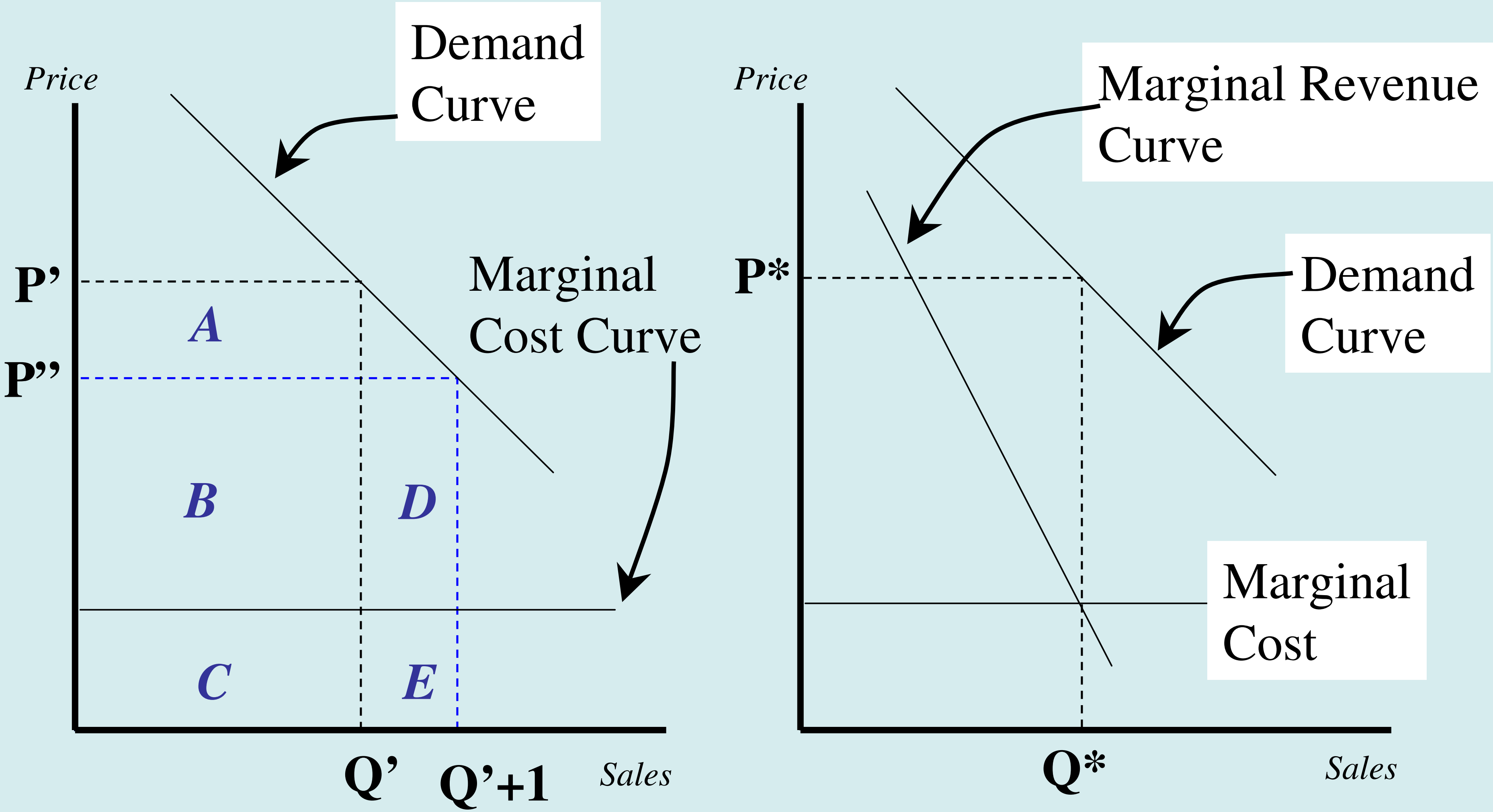
- Why M&A mostly within EU?
- Why UK's share so large?
  - Non harmonised takeovers rules.
    - some members have very restrictive takeover practices, makes M&As very difficult.
    - others, UK, very liberal rules.
- Lack of harmonisation means restructuring effects very impact by member states.

Theory: Economic Logic Verbally

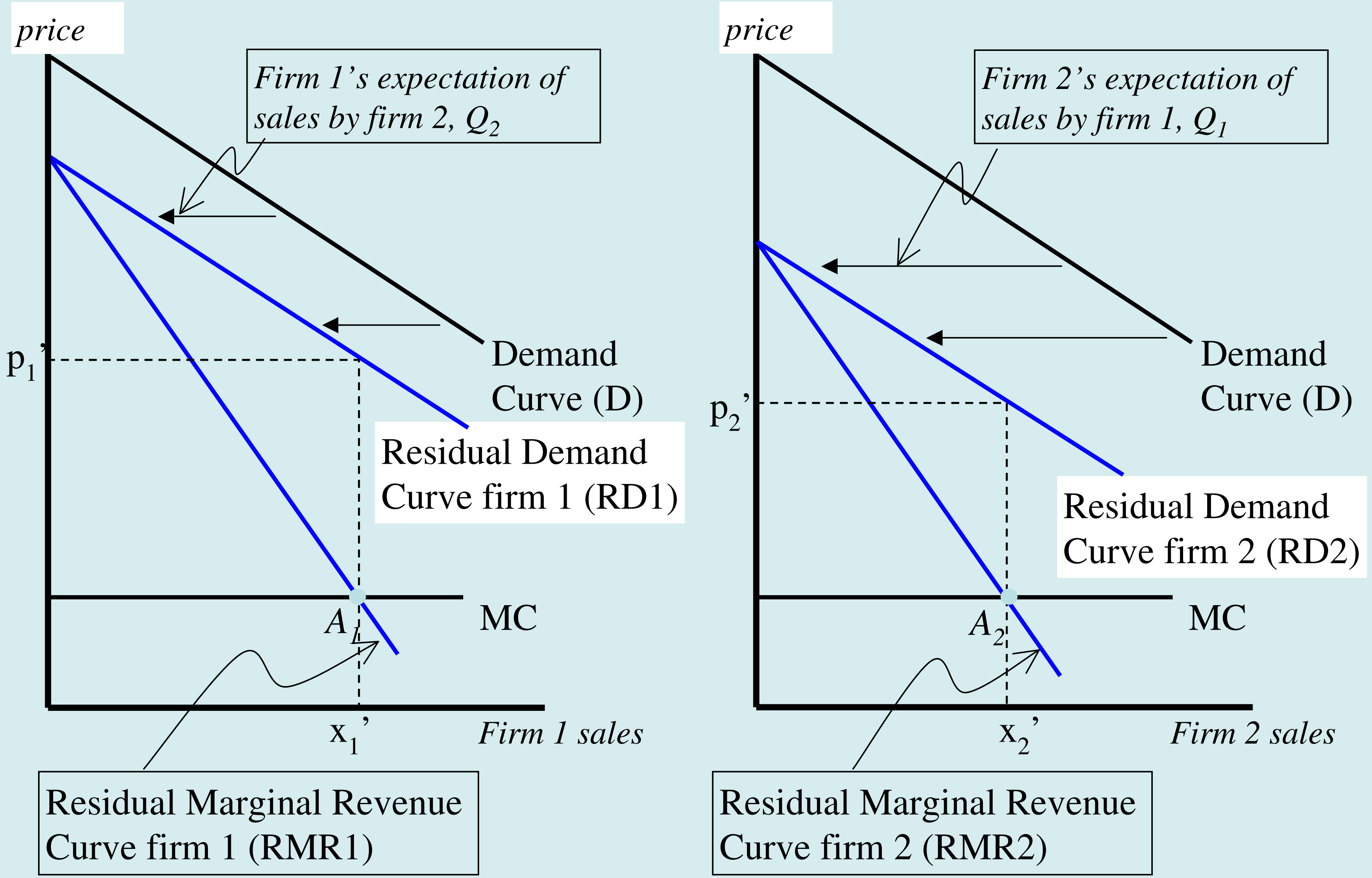
- liberalisation →
- de-fragmentation →
- pro-competitive effect →
- industrial restructuring (M&A, etc.)
- RESULT: fewer, bigger, more efficient firms facing more effective competition from each other.

Economic logic: background

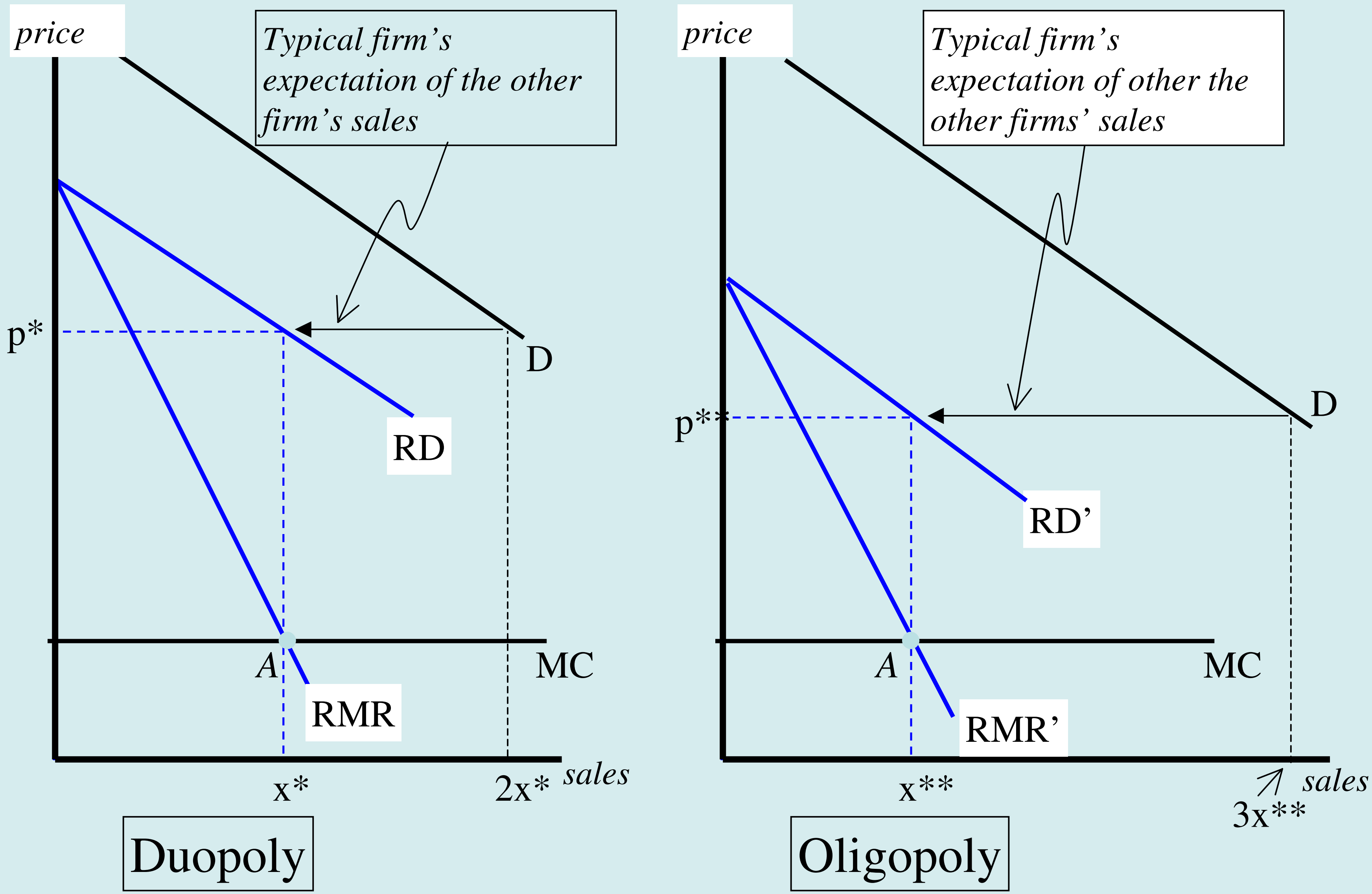
Monopoly case



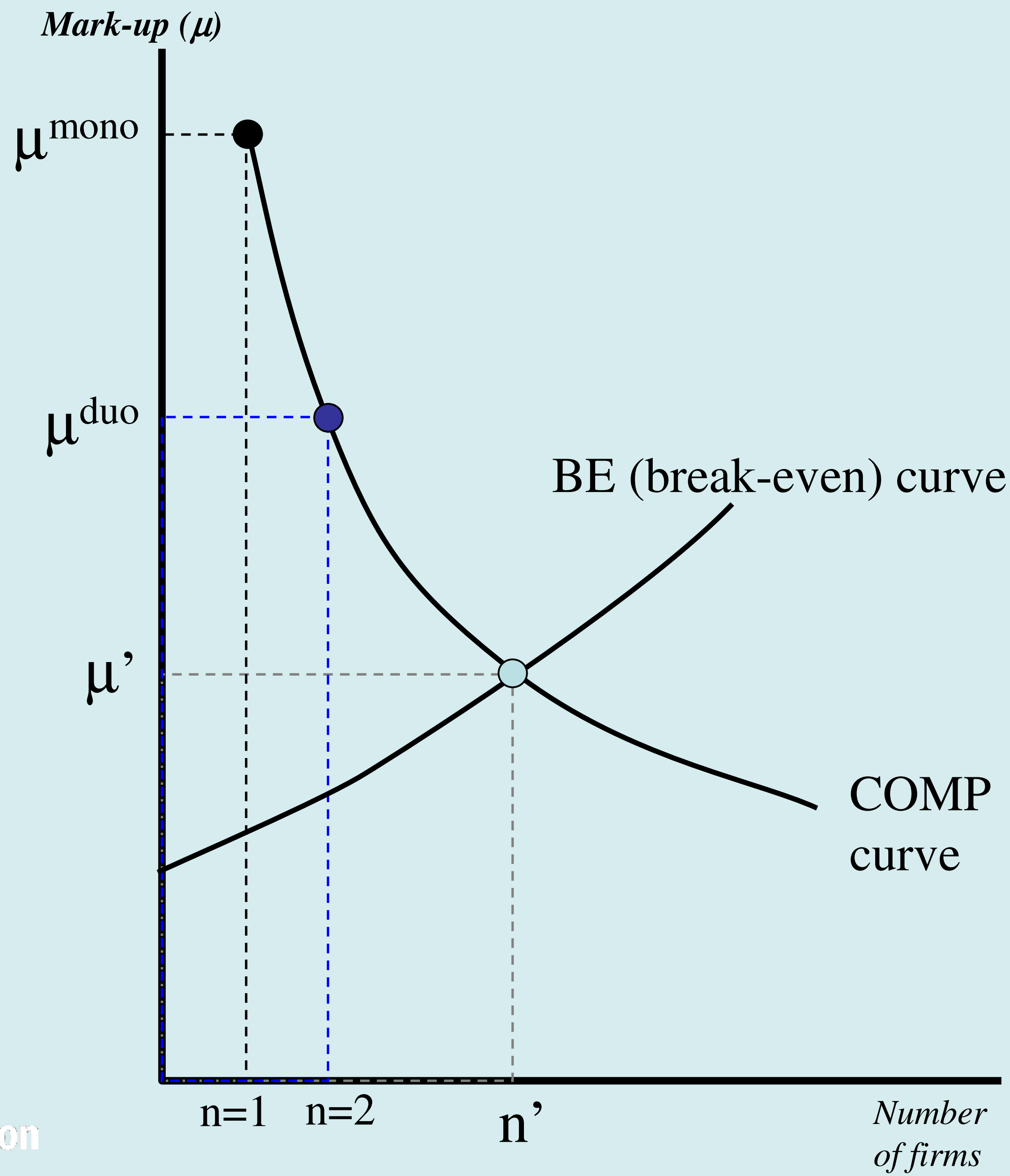
Duopoly case, example of non-equilibrium



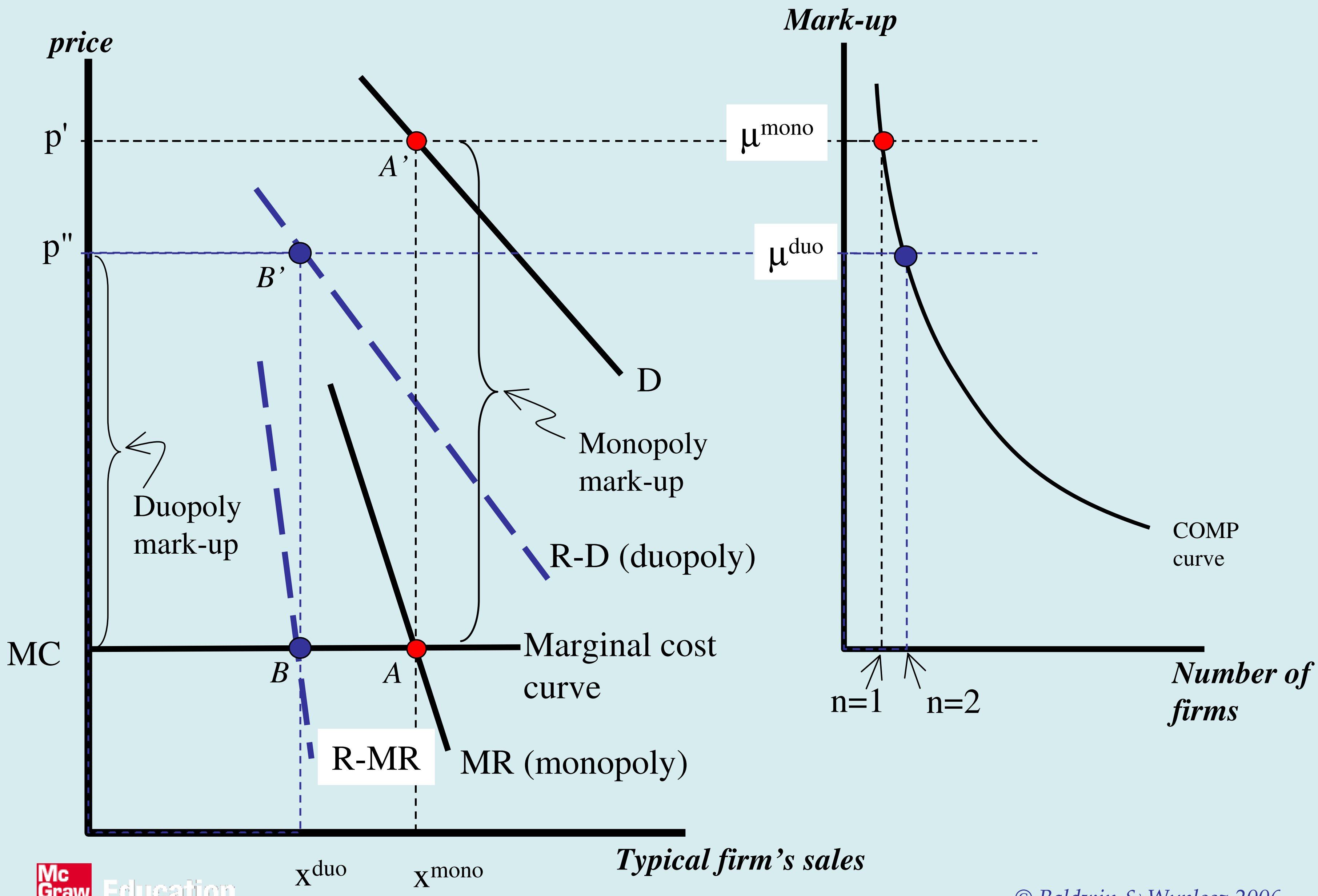
Duopoly & oligopoly case, equilibrium outcome



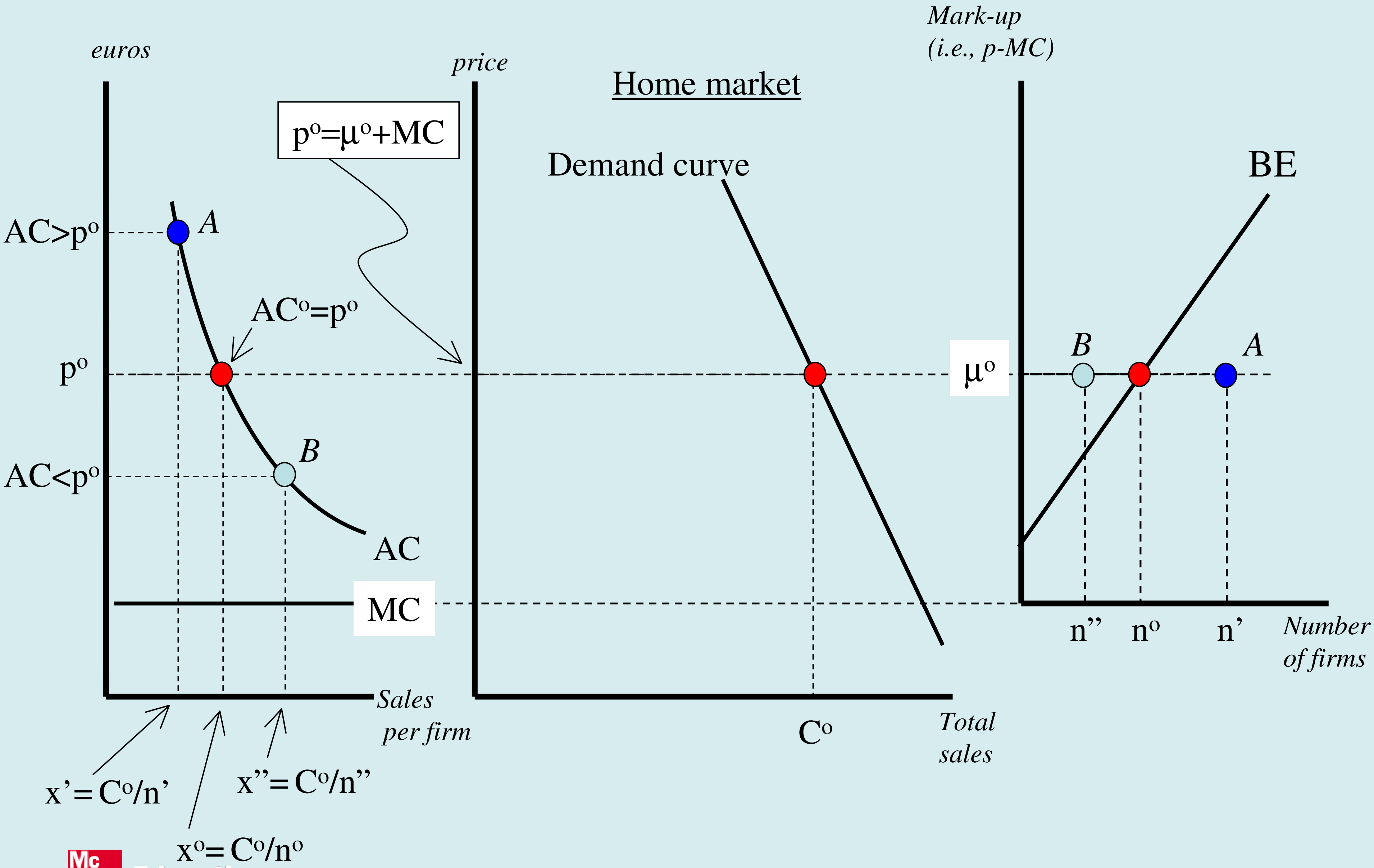
BE-COMP diagram



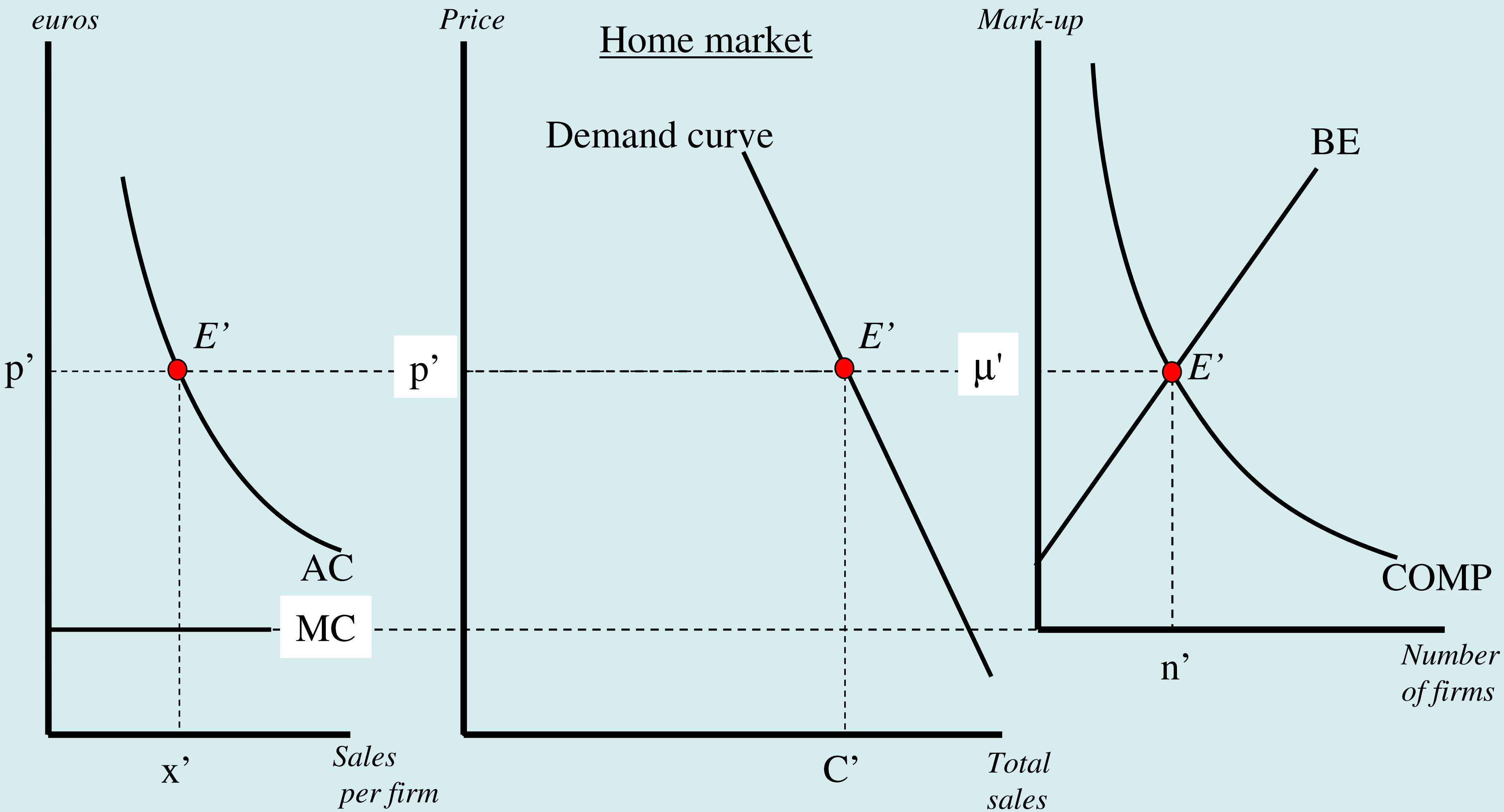
Details of COMP curve



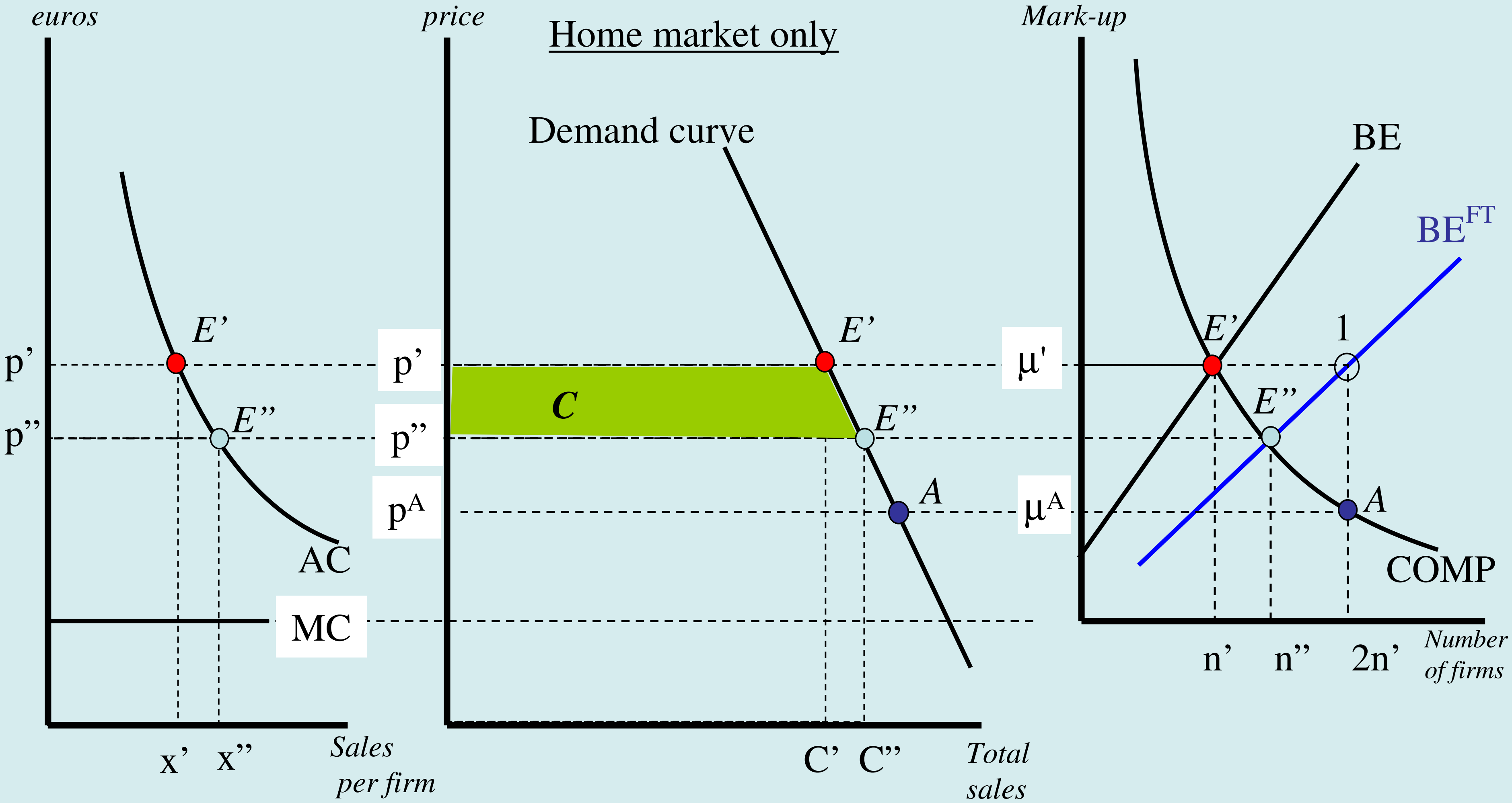
Details of BE curve



Equilibrium in BE-COMP diagram



No-trade-to-free-trade integration



Economic Logic

- Integration: no-trade-to-free-trade: BE curve shifts out (to point 1).
- Defragmentation:
  - PRE typical firm has 100% sales at home, 0% abroad; POST: 50-50 ,
  - Can't see in diagram.
- Pro-competitive effect:
  - Equilibrium moves from E' to A: Firms losing money (below BE).
  - Pro-competitive effect = markup falls.
  - short-run price impact p' to p^A.
- Industrial Restructuring:
  - A to E",
  - number of firms, 2n' to n".
  - firms enlarge market shares and output,
  - More efficient firms, AC falls from p' to p",
  - mark-up rises,
  - profitability is restored.
- Result:
  - bigger, fewer, more efficient firms facing more effective competition.
- Welfare: gain is "C".

Competition & Subsidies

- 2 immediate questions:
  - "As the number of firms falls, isn't there a tendency for the remaining firms to collude in order to keep prices high?"
  - "Since industrial restructuring can be politically painful, isn't there a danger that governments will try to keep money-losing firms in business via subsidies and other policies?"
- The answer to both questions is "Yes".
- See Chapter 11, 2nd Edition.