Intelligence MEMOS

From: Lawrence P. Schwartz

To: Canada's Competition Law Community

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Re: **StatsCan Data Enriches Competition Surveys: Let's Have More, Please**

The Competition Bureau's recent study on competition finds that "competitive intensity" decreased from 2000 to 2020. Does this important study deal adequately with the available Canadian research and the continuing questions about competition policy?

In one important respect, the answer is yes. For this research the Bureau has, apparently for the first time, drawn on Statistics Canada's linked databases to include information from all firms that file taxes in Canada.

The study focuses principally on industrial concentration and related structural measures such as entry/exit rates, incumbents' market shares, entry barriers and their resulting effects on firms' profits. In this respect, the research paradigm follows that of Professor J.E. Bain and many others who have followed the "structure-conduct-performance" paradigm in which the study of concentration is the initial step and from which performance follows.

The study starts from the premise that firms in concentrated industries find it easier to raise their prices and earn excess profits. It measures concentration in an industry by calculating the 10-firm concentration ratio (CR10), i.e. the share of the industry's output produced by its 10 largest firms. The CR10 can vary between zero and 100 percent; if the 10 largest firms in an industry each account for 5 percent of industry revenues, the CR10 will be 50 percent, which may or may not be viewed as high. Other commonly used concentration measures are the four-firm ("CR4") and the three-firm ("CR3") ratios.

The Bureau's study also calculates the Hirschman-Herfindahl Index of market power (HHI) which uses the market shares of all firms in an industry, not just those in a particular group. The HHI equals 10,000 for an industry with a single firm, while an HHI close to zero means there are many firms in the industry with low market shares.

This emphasis on market structure (i.e., shares and concentration) suggests that competition policy should promote competitive intensity by focusing on preventing/reducing industrial concentration. It is noteworthy that the Commissioner has supported the return to structural analysis in US antitrust. Recent proposed amendments to the merger provisions of the *Competition Act* are in this spirit; for example, the government proposes abolishing s.92(2), which currently disallows an order against a merger on the basis of concentration or market share alone.

The overriding feature from the various charts in the Bureau's study is that its measures of concentration have been generally stable over time. The Bureau's claim that concentration rose in the most concentrated industries can be challenged.

This tendency toward stability in market shares has a long history. An early and influential 1957 study of Canadian manufacturing industries found, inter alia, considerable stability in concentration patterns. A seminal 1950s US study found that industry concentration changes "at the pace of a glacial drift" and a more recent study, asking whether the "rule of reason" approach adopted in the 1980's plausibly affected market concentration, finds that US concentration had not changed "on average" over the twentieth century, in part because various industries' concentration ratios had risen before and after the introduction of that rule. The first study of concentration in Canada to use Statistics Canada's linked databases reported that, for the period 1970-79, 132 of the 167 Canadian manufacturing industries remained in the same CR4 class and 135 had remained in the same HHI class.

The Bureau's study examines the extent to which the 10 largest firms in an industry were in the top 10 for three prior years and reports that such "rank stability" has increased across all industries. This "could mean that competitive intensity has gone down," it says. However, rank stability does not preclude significant competition for market share among firms. A significant decline in the market share of a firm in the top 10 may not suffice to move it out of that category.

Does stability mean that "competitive intensity" has not improved in Canada since 1970? The same Canadian study found that though more than 50 percent of greenfield entrants in a cohort-year die within 10 years, 40 percent survive. These survivors add to intensity of competition in successive years.

Other Canadian research classifies manufacturing firms and plants as "entrants," "exits" and "continuing/incumbents," and examines which ones gained market share through plant creation and expansion, and those that lost market share via contraction and closure. The average value of this market-share turnover is 36 percent across all Canadian manufacturing industries, with a minimum of 6 percent and a maximum 72 percent for the period 1970 to 1979. This turnover was the result of both entry/exit and share reallocation among continuing/incumbent firms. More recent Statistics Canada research finds that such turnover contributed positively to productivity growth in all the service-sector industries studied. These studies of intra-industry mobility would not be possible without the linked databases developed by Statistics Canada.

Stability does not preclude mobility; indeed, they are different sides of the same competitive-analysis coin. It would be most helpful if the Bureau would use its capabilities with Statistics Canada's linked database to conduct studies of competition at the intra-industry level and include the extensive body of Canadian competition research from Statistics Canada in its thinking about competitive intensity.

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