

## 3.4.7 Contestability

- *Characteristics of contestable markets*
- *Implications of contestable markets for the behaviour of firms*
- *Types of barrier to entry and exit*
- *Sunk costs and the degree of contestability*
  
- Contestability: the ease with which firms can enter or exit an industry
- Characteristics of contestable markets:
  - Low barriers to entry and exit
  - Low sunk costs
  - Low levels of supernormal profits
  - Low concentration ratios
  - Low levels of collusion
  - New firms entering or leaving the market
  - Low levels of consumer churn
- Implications of contestable markets for the behaviour of firms:
  - Contestable markets are more likely to be allocatively efficient and productively efficient in the long term
  - Firms are wary of the threat of new competition even if there isn't much competition in the present
- Sunk costs: unrecoverable costs which cannot be recouped if the firm closes down which makes failure more expensive.
- Barriers to entry: obstacles that prevent a firm from setting up or extending its reach into new markets
- Barriers to exit: factors which prevent a firm from leaving a market such as irretrievable costs
- Types of barriers to entry:
  - Those which are deliberately imposed and can be seen as regulators as illegal and anti-competitive:
    - Predatory pricing
    - Limit pricing
    - Mergers- control of important technology
  - Natural barriers:
    - Economies of scale
    - Minimum efficient scale
  - Those which are imposed by the authorities in case there is too much competition:
    - Legal barriers such as patents
    - State-owned franchises
    - Legislation to allow firm to operate, such as licences
- Policies to increase contestability:
  - Deregulation
  - Open up networks of monopolies
  - Tough rules on predatory pricing
  - Encouraging international trade
- There are different degrees of contestability