

PARTIAL AND GENERAL EQUILIBRIUM IMPLICATIONS OF AN ALTERNATIVE APPROACH TO X-EFFICIENCY

by

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ABSTRACT

In this work a theoretical model is developed to investigate the impact of product market competition on firm efficiency and resource allocation in unionised industries/economies.

The main assumptions of the model are: (a) the product market is monopolistically competitive; (b) firms have Cobb-Douglas production functions; (c) firm unions affect directly the level of employment within each firm; (d) the likelihood for a given firm to go bankrupt increases with its level of inefficiency; and (e) the more competitive is the product market, the more likely it is that an inefficient firm goes bankrupt.

It is shown that, in equilibrium, (i) firms are inefficient, in the sense that the technical rate of substitution between labour and capital differs from the factor price ratio; (ii) when product market competition is raised the gap between the technical rate of substitution and the factor price ratio becomes smaller (that is, firms become more efficient). If labour supply is rigid, (iii) allowing unions to affect employment (assumption (c)) raises equilibrium employment but reduces output and welfare and (iv) increasing product market competition raises output and welfare but lowers employment.