

Competition and Institutions

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June 8, 2015

Abstract

Using a database of the World Economic Forum, I search for variables that correlates with competition. The intensity of competition in a country could have an economic or political explanation. I found that the availability of credit and the extent of protection against expropriation correlate with a more competitive environment. This result shows even controlling for development and legal family tradition.

1 Introduction

One of the main economic advocacy is competition. It yield an efficient resource allocation, promotes the lowest price for goods and services, and lead to innovation.¹ On pure economic grounds, there is an extended agreement on the benefits of competition among firms. This policy advocacy becomes less clear when institutions that support market transactions do not function well. If firms lack access to finance, then monopoly power could be the source of growth for firms (Rodrik (2008)). Lack of competition could also easy the way of firms to adopt frontier technology (Acemoglu, Aghion, and Zilibotti (2006)). But lack of competition came at a cost. When political considerations came into place, the economy could found itself trapped in an equilibrium which include monopoly rents and no convergence to the world frontier (Acemoglu, Aghion, and Zilibotti (2006)). Monopoly rents also create powerful groups that will later oppose the

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¹See Mas-Colell, Whinston, and Green (1995) for a classic textbook exposition and Aghion and Griffith (2005).

introduction of competition that can dispute their rents (Posner (1975), Stigler (1971) and Peltzman (1976)).

Although competition is one of the most relevant microeconomic policy, less is clear on how to promote competition and competitive markets at the economy level. That is to say, are there differences in competition across countries? One mechanism to enforce competition in the economy is to introduce competition laws. By 2008, 111 countries in the world have enacted competition laws. But enforcing those laws is complex. By its nature, they require high technical capabilities, accountability and transparency in order to avoid corruption and political intervention. Up to my (limited) knowledge, there is no study that try to establishes regularities in cross countries comparison on the overall degree of competition in the economy, or on the effectiveness of the application of antitrust or competition laws.

The implementation and enforcement of competition policies is the result of a highly political process. Not only economic factors determine the overall competition in a country, but also how institutions are designed to cope with pressures of very powerful interest groups. As with regulation (Laffont (2005) and Estache and Wren-Lewis (2009)), several difficulties surround the enforcement of competition policy. That is to say, the first order economic optimum need not be the one that could be optimal when the institutional environment is taken into account (Williamson (1996)). Take as an example the renegotiation process of concessions in Latin America. Guasch, Laffont, and Straub (2007) analyze the institutional environment that promote renegotiation of contract concession in the water and transport sector. They found that having a regulatory body before concession contracts strongly reduces the likelihood of the government renegotiating the contract.² From an institutional point of view, both variables -government renegotiation and the set up an independent regulatory agency- are jointly determined. Governments that know they will renegotiate in the future will not set up an independent regulatory agency today.

Institutions are a rather broader concept which scope and meaning varies according to different authors. North (1990) establishes that institutions represent constraints to human interaction that facilitate cooperation. They could be formal or informal, and can further be refined into include economic, political and social institutions. Other authors emphasize one kind of institutions over others. Acemoglu, Johnson, and Robinson (2005) establishes that political and economic institutions are interlinked, and that both

²This result do not hold for renegotiation initiated by firms, see Guasch, Laffont, and Straub (2008).

affect economic performance, mainly growth. Lopez-de Silanes, La Porta, and Shleifer (2008) offer a different interpretation and suggest that formal rules -in the form of the legal tradition that a country has- have an impact on several economic outcomes. In turn, differences in economic institutions (ownership of banks, bankruptcy law, labor laws, among several others) should have an impact on growth.

Both analysis creates difficulties for disentangling the source of causation, as one variable has dynamics effects on many others. This is made explicit in Lopez-de Silanes, La Porta, and Shleifer (2008) (see pages 293-294). Put it in other way, the institutional environment that create the conditions to adopt/adapt a legal tradition set in motion later institutions. Acemoglu and Johnson (2005) instrument their settler mortality and population density in 1500 and legal origin to explain property rights institutions versus contracting institutions, and find evidence for their instruments explaining property rights institutions. The crucial factor for development is how to restrict the expropriation of powerful elites.

In this paper I focus on one economic institution: competition. Postponing discussion of data to Section 2, it seems that countries that are more competitive also growth more. Next figure shows that richer countries seems to have more competitive markets.

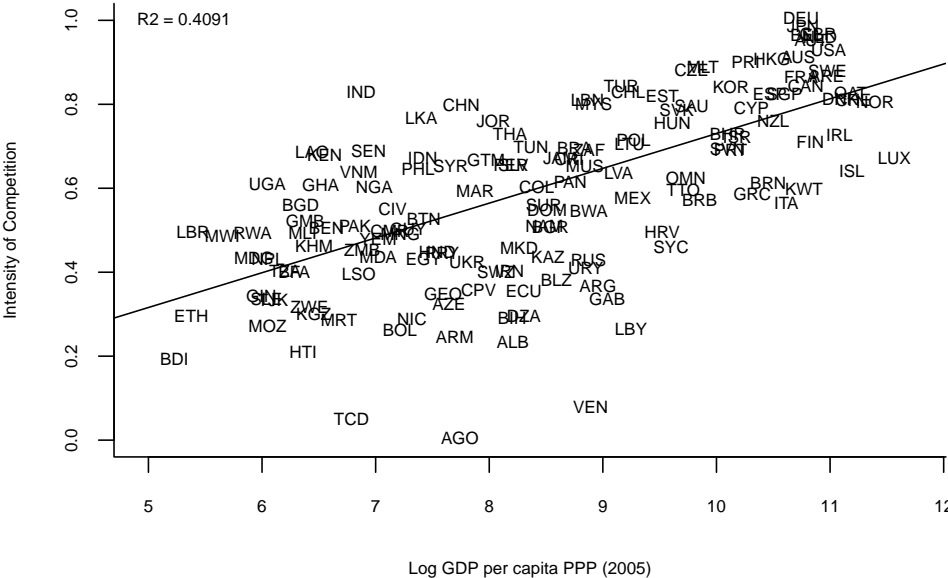


Figure 1: GDP per capita and intensity of competition.

1.1 Competition

What should both institutional theories though about market competition? In the Acemoglu, Johnson and Robinson tradition, countries with weak institutions should not favor market competition. For those elites in power, market competition means extracting less rents from market transaction and create opportunities for the emergence of potential threats to its economic power. We should expect that countries with extractive institutions should have lower competition than those with inclusive institutions. Using data for settler mortality (see Acemoglu, Johnson, and Robinson (2001)), next figure show this negative correlation.

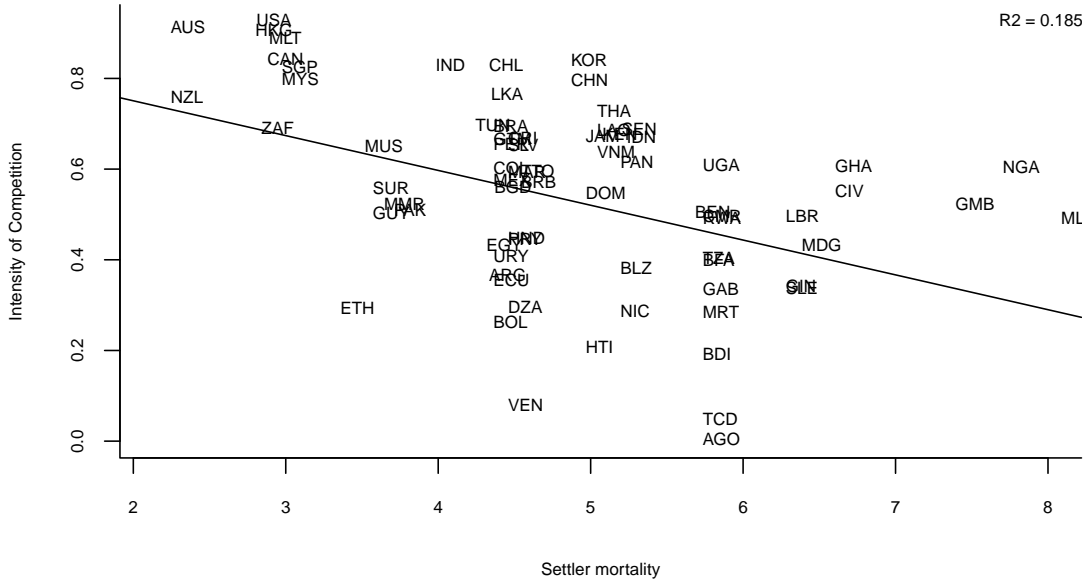


Figure 2: Settler mortality and intensity of competition.

Legal theories are based on the presumption that Common Law favor the individual over the State (Djankov, Glaeser, Porta, de Silanes, and Shleifer (2003), Levine (2005) for a useful discussion). On the other side, French Civil Law is viewed as an instrument of the government to control individuals. Civil and Common Law traditions has different histories towards competition and monopolies. As early as 1599, prior to the Glorious Revolution of 1688 that is referred as a landmark for protection of property rights against expropriation (Acemoglu, Johnson, and Robinson (2005)), the “Case of

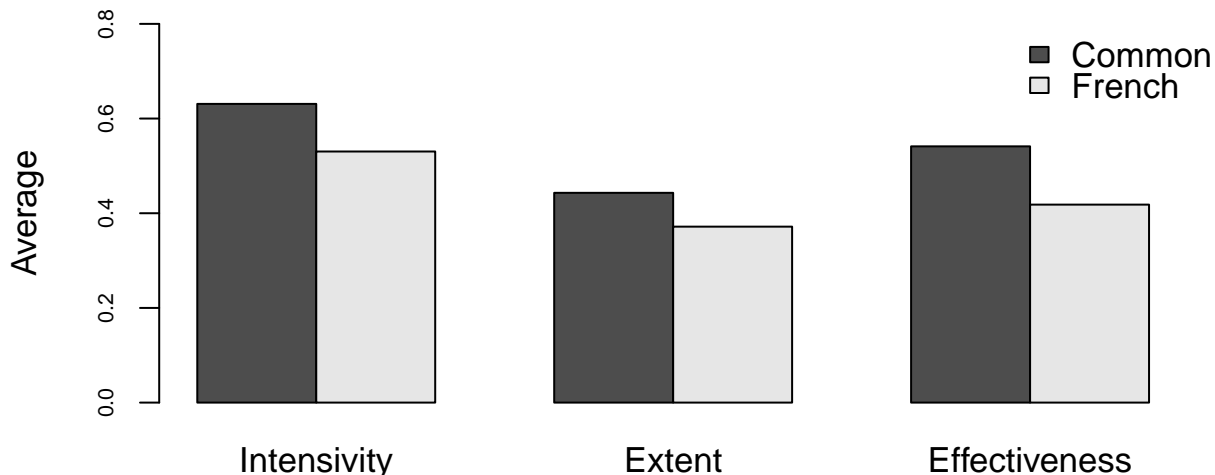


Figure 3: Average competition by legal tradition.

Monopolies”³ established that the Queen of England’s granted monopoly were invalid. Although directed to monopolies created by the rulers, this case set up a clear hostility towards monopolies in England. No such provision can be found in French Civil Law, which in some countries tend to develop “Supply laws” to directly regulate supply. In this regard, we can conjecture that French Civil Law countries should be less worried about competition, as they intervene more directly in the economy (La Porta, Lopez-De-Silanes, and Shleifer (2002)). On average, countries with French Civil Law has a significant less competitive economy as compared to Common Law countries. Next figure plot the average for three competitive measures: Intensity of competition, Extent of market dominance, and Effectiveness of Anti-Monopoly laws (see, section 2).⁴

The literature about institutions shed light on one key aspect: over time there is an equilibrium between institutions. This means that its impossible to study causation with contemporary data, even if this data differs in time. Relating data with one decade of difference in time will not reveal any possible causation, as both variables could have been set hundreds of years ago. This is the main point in both Acemoglu, Johnson and

³See <http://oll.libertyfund.org/titles/911/106358>

⁴Intensity: significant at 5%; Extent: significant at 10%; Effectiveness: significant at 1%.

Robinson, but also for La Porta, Lopez-de-Silanes, Shleifer and coauthors. This is also stressed by Alesina and Giuliano (2013) in their analysis about the interaction between formal and informal -culture- institutions (page 38). In this paper, I concentrate on the impact of alternative visions of institutions -economic and politics- on the extent and deep of competition in an economy. Competitions in the market should be affected by various factors. On the economic side: the existence of a -independent- competition enforcement agency, the availability of financial resources for entering the market and compete with existing firms, the openness of the economy to foreign trade, and the relative size of the economy. On the political institutions side: the degree of corruption in an economy, the restrains on the executive, rule of law, and protection against expropriation by the ruling elite.

2 Data

Each year the World Economic Forum, an international institution,⁵, issue the “Global Competitiveness Report” aims at constructing indicators on twelve pillars. Pillar six measure “Goods Market Efficiency” and include sixteen indicators that evaluate several characteristics of markets and in time are summed up in two categories: Competition (domestic and foreign) and Quality of demand condition. In the category of (domestic) competition it include three questions aimed to directly tackle the competitive environment, which are “Intensity of local competition”,⁶ “Extent of market dominance”⁷ and “Effectiveness of anti-monopoly policy”⁸. Those questions are usually surveyed to qualified informers, and answers averaged to obtain the country number.

Data on the three measures is available for years 2006 through 2014.⁹ For each measure, I average the index for each country in the period. The correlation between each index, showed below, is pretty high. Although each measure different elements of the competitive landscape, answers shows that they seems to be linked by respondents. Each measure is on a one to seven scale, but I normalize it to a zero to one scale.

⁵See <http://www.weforum.org/world-economic-forum>

⁶“In your country, how intense is competition in the local markets? [1 = not intense at all; 7 = extremely intense]”.

⁷“In your country, how would you characterize corporate activity? [1 = dominated by a few business groups; 7 = spread among many firms]”.

⁸“In your country, to what extent does anti-monopoly policy promote competition? [1 = does not promote competition; 7 = effectively promotes competition]”.

⁹Data is available at http://www3.weforum.org/docs/GCR2014-15/GCI_Dataset_2006-07-2014-15.xlsx

Table 1: Correlation between competition measures.

(Critical value at 5% = 0.1587, n = 153.)

Intensity of Local Competition	Extent of Market Dominance	Effectiveness of Anti-monopoly Law	
1.0000	0.7990	0.8504	Intensity
	1.0000	0.8460	Extent
		1.0000	Effectiveness

Also, the variability of the variables over the period seems to be narrow. I measure the difference between minimum and maximum of each variable and found relative stability.

- Add box with distribution of variability for each variable.

On the other side, I use two different institutional measures. First, economic variables that can affect competition in the market. This include the richness of consumers (GDP PPP per capita), the openness of the economy for trade (Imports over GDP), the extent of credit available either for consumer or firms (Private Credit over GDP), and the extent of the market (population). I avoid usual measures of barriers to entry developed initially in Djankov, La Porta, Lopez-De-Silanes, and Shleifer (2002), as the effect of this measure as a real barrier for potential entrants has been empirically questioned (see Branstetter, Lima, Taylor, and Venâncio (2014) for the impact of deregulation of entry in Portugal and Kaplan, Piedra, and Seira (2011) for Mexico).

Secondly, I evaluate institutional variables that may influence competition in the market. Institutions affect market outcomes in several ways. They can shape the political process which protect -or not- property rights and have an impact on development (Acemoglu, Johnson, and Robinson (2001), Acemoglu, Johnson, and Robinson (2002), Acemoglu and Johnson (2005), among others). Institutions also shape the deep and extent of financial markets (La Porta, de Silanes, Shleifer, and Vishny (1997), La Porta, de Silanes, Shleifer, and Vishny (1998), La Porta, Lopez-De-Silanes, and Shleifer (1999), Djankov, McLiesh, and Shleifer (2007), Djankov, Hart, McLiesh, and Shleifer (2008), Beck, Demirgüç-Kunt, and Levine (2003), among others contributions) which affect the availability of finance to firms. Nowadays, most market countries in the world have competition laws and agencies that enforce it. This laws, if applied adequately, have

a direct impact on the competitive landscape were firms operate. Nevertheless, competition laws are enforced through litigation, which opens the door to corruption and inefficiency of officials in charge. As a measure of the institutional setting, I analyze the effect of corruption, the rule of law and government effectiveness, which are usually used in empirical analysis (see La Porta, Lopez-de Silanes, Shleifer, and Vishny (1999)). Also, I control for unobservables using legal origin of the country. As Lopez-de Silanes, La Porta, and Shleifer (2008) notes, legal origins are correlated with several measures of the institutional environment upon which firms compete, such as labor regulations, market entry regulations, bankruptcy laws and government ownership of banks. The appendix has a detailed description of variables and sources of data.

- Descriptive statistics for variables in the data here

3 Empirical analysis

I follow a methodology for understanding the institutional environmental of competition. First, without acknowledge the intertwined nature of institutions, I explain competition as a result of market conditions. Note that this analysis do not presume that explanatory variables are exogenous, but just to correlate variables. Then, I introduce other institutional variables that have influence either on those economic variables.

3.1 Economic explanations

At the macro level, competition in a country should be affected by its size, relative richness of its citizens, its financial development -which affect firms to growth and enter the market and consumers to anticipate consumption- and the degree of openness to foreign competition. Each of this variables should be positively associated with the two measures of competition (intensity and extent). I estimate the following regression by OLS:

$$comp = \alpha + \beta_1 \times GDP + \beta_2 \times (Imp/GDP) + \beta_3 \times (PCred/GDP) + \beta_4 \times Pop + \varepsilon$$

All variables are in logarithms and year 2005. Although right hand variables are lagged regarding the explained variable, which is an average for 2006 - 2014, they tend to have high inertia over time, so it should not be as a causation effect. *Comp* is either “Intensity of local competition” or “Extent of market dominance” for which

lower values means lower competition. Although it could also be measured “Efficiency of Anti-monopoly law” it make less sense to regress it on economic variables. Next table shows the results for each variables.

Table 2: OLS results for economic variables.

	<i>Intensity</i>		<i>Extent</i>	
Constant	-0.6571*** (0.1774)	-0.6101*** (0.1766)	-0.7625*** (0.1881)	-0.7164*** (0.1877)
log (GDP p/c)	0.0438*** (0.0113)	0.0441*** (0.0112)	0.0571*** (0.012)	0.0574*** (0.0119)
log (Imp/GDP)	0.0148 (0.0136)	0.0113 (0.0135)	-0.00245 (0.0144)	-0.0059 (0.0144)
log (PCred/GDP)	0.1012*** (0.0185)	0.0964*** (0.0184)	0.0653*** (0.0197)	0.0606*** (0.0196)
log (Pop)	0.0287*** (0.0076)	0.0290*** (0.0075)	0.0305*** (0.008)	0.0308*** (0.008)
French legal origin		-0.0501** (0.0237)		-0.0491* (0.0252)
Adjusted R Squared	0.57	0.58	0.51	0.52
# observations	144	144	144	144

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

All variables have the expected sign in both specifications. Imports is insignificant to explain competition at the aggregate level, once controlled for other variables, which is a result in itself. Interestingly, following Lopez-de Silanes, La Porta, and Shleifer (2008), I include French legal origin in the regression in order to control for unobserved factors, but sign and significance of variables do not change. Initially, competition in a country seems to correlate with its richness, its size and the availability of credit for firms and consumers.

3.2 Institutions

Competition could also be the result of the institutional environment, which could either foster or hinder it. Political economy considerations are key for enforcing an antitrust law, mainly when dominant firms are in place and can use their connections with the government. I use standard measures of political economy such as restrictions

on the executive, corruption, expropriation risk and rule of law. On a second regression I control for GDP. I estimate the following regression by OLS:

$$comp = \alpha + \beta_1 \times Corrup. + \beta_2 \times Rule + \beta_3 \times Protection + \beta_4 \times Constrains + \varepsilon$$

Results are presented in the next table.

Table 3: OLS results for institutional variables.

	<i>Intensity</i>		<i>Extent</i>	
Constant	0.0235 (0.0859)	-0.0662 (0.0954)	-0.1314 (0.0869)	-0.2121** (0.0966)
Corruption	-0.005 (0.0123)	-0.004 (0.0121)	0.0028 (0.0125)	0.0041 (0.0122)
Rule of Law	0.0064 (0.0244)	-0.005 (0.0243)	0.0449* (0.0247)	0.0339 (0.0246)
Prot. against Exprop.	0.0817*** (0.0199)	0.0607*** (0.0215)	0.0645*** (0.0201)	0.0448** (0.0218)
Constrains on executive	0.000 (0.0095)	-0.0011 (0.0094)	-0.0129 (0.0097)	-0.0136 (0.0095)
GDP per cápita		0.0336** (0.0157)		0.0308* (0.0159)
Adjusted R Squared	0.41	0.42	0.49	0.50
# observations	102	101	102	101

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

	<i>Effectiveness</i>			
Constant	-0.1384 (0.0845)	-0.217** (0.0953)	-0.1845** (0.0704)	-0.2497*** (0.0799)
Corruption	0.0202* (0.0121)	0.0204* (0.012)	0.0766** (0.0349)	0.0195* (0.0103)
Rule of Law	0.0215 (0.024)	0.0131 (0.0243)		
Prot. against Exprop.	0.0696*** (0.0196)	0.0529** (0.0215)	0.0779*** (0.014)	0.058*** (0.0176)
Constrains on executive	-0.01 (0.0094)	-0.0113 (0.0094)		
GDP per cápita		0.0281* (0.0157)		0.0268* (0.0148)
Adjusted R Squared	0.55	0.55	0.55	0.55
# observations	102	101	105	104

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

Expropriation risk is significant (and has the right sign). GDP per capita is significant at 10% and do not change the significance of Expropriation risk. In the regression of “Effectiveness of Anti-Monopoly Laws”, Corruption is slightly significant and has the right sign. Controlling for GDP per capita slightly change downwards the coefficients, but do not lose significance. When Constraints on the Executive and Rule of Law are excluded from the regression, the significance of Corruption increases significantly (not reported). As the enforcement of antitrust laws give authorities ample discretion over how to interpret rules, define markets, find dominance and set fines, the risk of corruption increases. All in all, Protection against expropriation seems to hold most explanatory power.

3.3 Economy and institutions

Economics and institutions can not be seen in isolation. Acemoglu, Johnson, and Robinson (2005) and Lopez-de Silanes, La Porta, and Shleifer (2008) shows the effect of institutions on economic outcomes. As far as we are showing correlations and the economic and institutional outcome could be settled jointly hundred of years ago, they

should interact in order to establish factors that affect competition. Using the results from previous sections, I analyze both economic and institutional factors. For each variable (“Intensity”, “Extent” and “Effectiveness”), I run different regressions to check the significance of variables that are most significant on individual analysis. I also control for GDP per cápita en legal origin. Results are shown in the next three tables.

Table 4: OLS results for economic and institutional variables.

	<i>Intensity</i>			
Constant	-0.0412 (0.0682)	0.0292 (0.0723)	-0.0252 (0.0613)	0.0535 (0.07)
Prot. against Exprop.	0.0269* (0.014)	0.0136 (0.0146)	0.0313*** (0.0113)	0.0253** (0.0114)
log (PCred/GDP)	0.1099*** (0.0208)	0.1026*** (0.0205)	0.1146*** (0.0189)	0.114*** (0.0185)
GDP per cápita	0.0078 (0.0144)	0.0187 (0.0147)		
French legal origin		-0.0731** (0.0294)		-0.062** (0.0282)
Adjusted R Squared	0.55	0.57	0.55	0.57
# observations	106	106	106	106

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

Table 5: OLS results for economic and institutional variables.

	<i>Extent</i>			
Constant	-0.2925*** (0.0733)	-0.2404*** (0.079)	-0.2641*** (0.066)	-0.2121*** (0.0765)
Prot. against Exprop.	0.0457*** (0.015)	0.0358** (0.016)	0.0535*** (0.0121)	0.0495*** (0.0124)
log (PCred/GDP)	0.0799*** (0.0224)	0.0745*** (0.0224)	0.0883*** (0.0203)	0.0878*** (0.0203)
GDP per cápita	0.0138 (0.0155)	0.021 (0.0161)		
French legal origin		-0.0539* (0.0321)		-0.041 (0.0308)
Adjusted R Squared	0.54	0.55	0.54	0.554
# observations	106	106	106	106

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

Table 6: OLS results for economic and institutional variables.

	<i>Effectiveness</i>			
Constant	-0.2822*** (0.0712)	-0.2039*** (0.0752)	-0.2731*** (0.0639)	-0.1825** (0.0725)
Prot. against Exprop.	0.0541*** (0.0145)	0.0394** (0.0556)	0.0567*** (0.0117)	0.0497*** (0.0118)
log (PCred/GDP)	0.0994*** (0.0217)	0.0913*** (0.0213)	0.1021*** (0.0197)	0.1013*** (0.0192)
GDP per cápita	0.0044 (0.0151)	0.0165 (0.0153)		
French legal origin		-0.0812*** (0.0305)		-0.0714** (0.0292)
Adjusted R Squared	0.6	0.63	0.61	0.63
# observations	106	106	106	106

Standard errors in parenthesis. Significance: ***1%; ** 5%; * 10%; no asterisk no significant.

When both economic and institutional factors are tacking into account, then the three measures of competition tend to differentiate. The only variable that is -highly-significant in all specifications is the availability of credit, even controlling for legal origin or GDP per capita. Legal origin is relevant for “Intensity of local competition“ and “Effectiveness of Anti-Monopoly law”, but not for the “Extent of market dominance”. For this last measure, the main explanations seems to be the availability of credit and the protection of property rights. That is, competition in a country is driven mainly by credit, which induces entry into the market, but also with a strong protection of expropriation, mainly for those newcomers into the market. French legal origin holds a significant negative impact on the “Effectiveness of Anti-Monopoly law”, which reassures the conjecture that French Civil Law tradition do not explicitly encourage competition and resort to other measures. Finally, “Intensity of local competition“ is affected again by the availability of credit, by the protection against expropriation -when not controlling for GDP per capita- and negatively by French legal origin. Note that although both GDP per capita and Credit to the private sector are determined by strong institutions (see Acemoglu and Johnson (2005)) the second one tend to have a high independent effect on competition.

4 Conclusion

Competition is one of the main political economy advise of economists. Nevertheless, there are no papers that study the nature of competition at the economy level. I study such correlations and find that the availability of credit is one of the main explanations for the intensity of competition in an economy. Although its size and richness seems to be relevant, this correlation disappears when controlling for institutional factors. Competition do not seems to be a luxury good, not something intrinsically attached to big economies.

What remains to be other powerful correlation is the protection against expropriation. This imply that not only economic factor could explain competition, but also institutional ones. The causation between competition and protection against expropriation seem to be more blurring.

A Sources of data

- TBD

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