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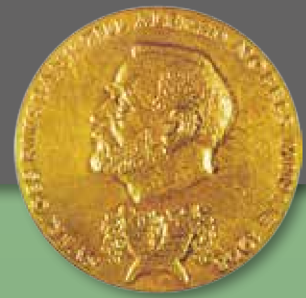
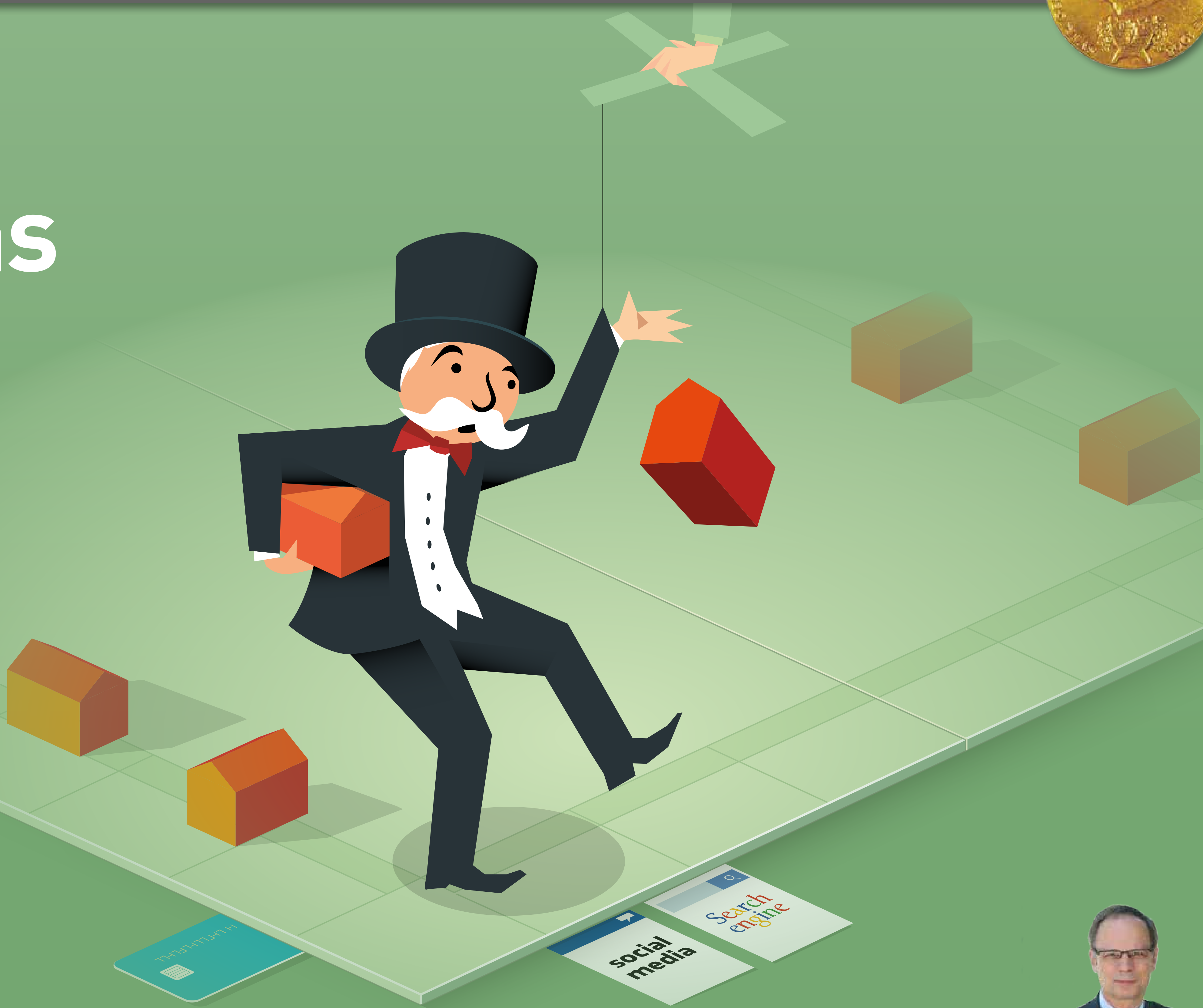
THE ROYAL SWEDISH ACADEMY OF SCIENCES

The Royal Swedish Academy of Sciences has decided to award the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel for 2014 to **Jean Tirole** "for his analysis of market power and regulation".

The Sveriges Riksbank Prize in Economic Sciences
in Memory of Alfred Nobel 2014



Taming powerful firms



Jean Tirole has been awarded this year's Prize in Economic Sciences for his analysis of how to understand and regulate markets with one or a few powerful firms. He has developed a unified theory with a strong bearing on central policy issues: how should the government deal with mergers and cartels, and how should it regulate monopolies and oligopolies?

Some markets only have room for a single producer, a monopoly. Traditionally these have included railways, motorways, water, post and telecommunications and, in smaller locations, welfare services such as schools, health and social care. Regardless of whether the firm is owned privately or by the state, it can be difficult to constrain a monopoly company so that it behaves in a desirable manner; often the costs are too high or the quality too poor. The regulating authorities cannot simply order the implementation of significant improvements, as they lack adequate information about the firm's feasible options.

Even in markets where there could be greater competition, it is sometimes the case – if the authorities do not intervene – that inefficient firms survive by preventing new and more productive ones from entering the market.

Since the mid-1980s, Jean Tirole has breathed new life into research on such market failures. He has used modern theoretical methods such as game theory (mathematical analyses of conflict and co-operation) and contract theory (how agreements can be reached when the parties have asymmetric access to information).

The overall conclusion is that there are no standard solutions that are applicable in every case. Instead, regulation and competition policies should be carefully adapted to each industry's specific conditions. Drawing on Jean Tirole's new insights, governments can better encourage powerful firms to become more productive and, at the same time, prevent them from harming competitors and customers.

How should regulating authorities ensure that the few large firms that dominate an oligopoly market compete on fair terms? The answer is that there is no single solution. Instead, Tirole states that it is necessary to find the specific solution that works best in each case.

How can the abuse of market power be prevented? Sometimes firms remain large not because they are more productive than others, but because they abuse their dominant position to stop newcomers with better ideas from entering the market.

Jean Tirole has also studied competition in digital industries, among so-called platform firms. Examples of platforms include search engines, social media, and credit cards. These differ from traditional goods and services and the firms should therefore be regulated differently. Platform firms connect two or more groups of customers, which are often treated very differently. For example, a search engine may be free of charge for individual users without this being regarded as harmful price dumping. On the contrary, free searches boost the number of users, which makes advertising firms more willing to pay for adverts.

Jean Tirole
French citizen. Born 1953 in Troyes, France. Scientific Director at Institut d'Économie Industrielle, Toulouse School of Economics, Toulouse 1 Capitole University, France.

FURTHER READING! More information on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2014: *http://kva.se/prizeeconomicsciences2014* and *http://nobelprize.org* **BOOKS:** ● **Tirole, J.** (1988) *The Theory of Industrial Organization*, MIT Press ● **Laffont, J-J.** and **Tirole, J.** (1993) *A Theory of Incentives in Procurement and Regulation*, MIT Press ● **Dewatripont, M.**, **Rochet, J.** and **Tirole, J.** (2010) *Balancing the Banks: Global Lessons from the Financial Crisis*, Princeton University Press ● **Laffont, J-J.** and **Tirole, J.** (1999) *Competition in Telecommunications*, MIT Press **LECTURE:** ● **Tirole, J.** (2013) Two-sided markets, *www.ut-capitole.ubicast.tv/videos/jean-tirole-two-sided-markets-feb-26-2013-part-1/*
● **More references can be found in the Scientific Background:** *http://kva.se/prizeeconomicsciences2014*

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