

# The meaning of competition between social and market rented housing

Paper to be presented at the ENHR Conference Prague, 28 June – 01 July, 2009  
Workshop 02 – Housing Economics, Governance and Regulation Policies

**Authors: Christian Lennartz<sup>1</sup>,**

<sup>1</sup>OTB Research Institute for Housing, Urban and Mobility Studies, Delft University of Technology, Jaffalaan 9, 2628 BX Delft, + 31-15-27-84120, [www.otb.tudelft.nl](http://www.otb.tudelft.nl), [c.lennartz@tudelft.nl](mailto:c.lennartz@tudelft.nl)

**Marietta Haffner<sup>1</sup>, Michael Oxley<sup>1,2</sup>**

<sup>1</sup>OTB Research Institute for Housing, Urban and Mobility Studies, Delft University of Technology, Jaffalaan 9, 2628 BX Delft, [www.otb.tudelft.nl](http://www.otb.tudelft.nl),

<sup>2</sup>Centre for Comparative Housing Research, De Montfort University, The Gateway, Leicester, LE1 9BH, [www.cchr.net](http://www.cchr.net)

## Abstract

When policy makers claim that rented housing has to become more competitive, there is no consensus on what competition in this context actually means. The same holds true for scientific housing research: Theories that have utilized the economic concept of competition tend to rely on implicit definitions or focus on selected aspects. In particular, one can identify a lack of understanding of competition between the different rented housing tenures. This paper tries to fill this gap as it sheds light on a more detailed meaning of competition in rental housing markets, what it entails, and how it can be assessed.

A brief review of competition in economic theory shows that opposing concepts have led to different connotations of the term. Building on the Structure-Conduct-Performance (SCP) paradigm and further theories of competition analysis, the paper intends to develop an innovative framework for analysing competition between social and market rented housing. The presented SCP framework of rented housing illustrates that the competitive relation between social and market housing is reflected in the economic and regulatory environment of the rental market, the behaviour of the landlords and tenants, as well as the economic and social effects of competition.

**Key words:** Competition, Structure-Conduct-Performance paradigm, rental housing markets, social housing, rental housing industry

Word count: 8,250 words (excluding tables, figures, and references)

# The meaning of competition between social and market rented housing

## 1 Introduction

In recent decades, housing policies in most European countries have become more market-oriented as the direct involvement of governments in the supply and funding of non-market housing has decreased (Maclennan & More, 1997; Haffner, et al., 2009). Central to the development towards a stronger reliance on market principles is the notion that providers of social housing have to become more competitive and that in general the idea of competition in rental housing markets needs to be enforced. The Cave report (2007) for the UK and Priemus (2003) describing the case of the Netherlands show that the competition agenda is promoted by policy makers who want social housing providers to rely more on private funding, request whole rented markets to become more efficient, and want social housing to offer more choice to tenants. This policy obviously underlies the idea that competition leads to a beneficial outcome of market interactions. In the meantime, competition in rental housing markets has also come to the attention of the European Union's competition authorities. The EC claims that in case of the Netherlands and Sweden the organisation and financing of social housing might inhibit a level playing field between social and market providers of rental housing (Elsinga, et al., 2008).

In this context scientific housing research has primarily focused on the meaning and effects of competition within social housing (e.g. Maclennan & More, 1997; Gibb & Nygaard, 2006). Only few works have analysed competition between social and market rented housing, whereas the following two studies can be seen as valuable exceptions: Kemeny's (1995) seminal work on competition between non-profit and profit providers of rented housing in unitary markets builds on the understanding that the competitive power of non-profits has a positive effect on rents and quality of profit providers. However, Kemeny's work is not based on any competition theory and is not grounded on any strong empirical verification. Atterhoeg and Lind (2004) distinguish between 'internal' and 'external competition', where the former means competition between firms in entire rental markets and the latter means competition between rental housing and owner-occupied housing. Testing the hypothesis that competition "would lead to lower prices, reduced costs, more innovation and generally a stronger position for the consumer" (ibid., 2004, p. 108), the study is clearly concerned with the effects of competition.

Nonetheless, it can be claimed that scientific housing studies concentrate on selected aspects and political practice relies on implicit assumptions of the concept of competition. As a result, one can identify a lack of understanding of competition between social and market housing. This suggests that the changing patterns of the relation of social and market renting in current European rental housing regimes, and with it the changing purposes of social housing systems are unclearly defined and explained (Tutin, 2008). It follows that the implementation of competition in housing processes is principally an uncertain process.

Against this background this paper pursues two main goals: First, it aims to shed light on the question of what competition between social and market housing in rental markets means and entails. Here, the paper will integrate different perceptions of competition in economic theory and try to present a more consistent picture than done by previous studies. Second, the paper aims at creating an innovative framework to

examine the conditions and factors influencing the degree of competition in rental markets and how to assess these.

### *Structure of the paper*

The next section is a conceptual review of competition in economic theory. It outlines the two main approaches to a conceptualisation of competition and how this has led to differing perceptions of what the term competition means. Section 3 presents the traditional approach to analysing competition – the Structure-Conduct-Performance paradigm (SCP) – in the economic field of industrial organisation (IO). The fourth section exhibits the special conditions of rented housing markets and thus shows why established approaches to the analysis of competition do not hold here. Section 5 applies a modified SCP to rental housing markets, thereby identifying the different connotations of competition between social and market rented housing. In the sixth section the possibilities of linking the three elements of an applied SCP in rental housing markets are discussed. The paper ends with a conclusion and a description of unresolved problems in section 7.

## **2 The economic meanings of competition - Two opposing concepts**

Although competition is one of the pivotal concepts in economic theory it has experienced different and even contrasting definitions and interpretations. The classical school, in particular Adam Smith, built its theories around the concept of competition as a process of rivalry between suppliers that eliminates excessive profits, removes excessive supplies and satisfies existing demand (Stigler, 1957). Hence, competition was seen as an ordering force which ensures efficiency of economic processes, since resources are steered to the most productive supplier (McNulty, 1968). Putting the aspect of rivalry into focus, Smith equated competition with a process of responding to new situations and as a means of achieving new equilibria in the market (Stigler, 1957).

In the following, two opposing concepts of competition evolved, both building on certain assumptions of the classical definition: The neo-classical concept of perfect competition considers competition as a state of affairs that depends largely on market forces such as demand and the cost structure of operating firms (Metcalf, 2000). Perfect competition relies on the five conditions that the products in the market must be homogeneous, all market actors must be equally well informed, suppliers maximise profits and consumers maximise utility, barriers to enter or exit must be low, and the number of sellers and buyers must be sufficiently high so that none can influence the market price (Motta, 2004). The price-taking condition implies that no supplier is able to exert market power, meaning that firms do not price profitably above the marginal cost of production. Neo-classical economists argue that when this condition is fulfilled, the outcome of the market is efficient and welfare-optimal (Tirole, 1988). Testing the conditions of a market against these five conditions, the concept of perfect competition has become an analytical device that allows for a categorisation of each market into imperfectly competitive markets and perfectly competitive ones. As a result, in the neo-classical school of thought the idea of market structure and competition were merged (McNulty, 1968).

This equalisation was criticised by the (Neo-) Austrian school of economic thought. It not only states that the general assumptions of the concept of perfect competition are unrealistic; it is also noted that in a state of perfect competition there would be no competition at all, because the effects of competition have reached their limit. Instead, Neo-Austrian economists see competition as a dynamic force, since in business practice it is foremost an incentive to behave (slightly) different as rivalling

firms. In this context Hayek's main idea is that competition is based on uncertainty, thereby being a process of discovery. This implies that market actors face the risk not to be successful in achieving their aims and can be driven out of the market. Furthermore, an equilibrium state is not possible, since firms adapt their behaviour in search for new profit opportunities, which means that profits do not imply inefficiencies in the market – as the concept of perfect competition suggests –, but they signal adapting and efficient business behaviour of individual suppliers (Hayek, 1948). The concept of Schumpeterian competition, based on the idea of a 'creative destruction', goes a step further: Competition is less seen in terms of adapting prices, but it understands new technologies and new types of organisations (innovation) as the driving economic force. Schumpeter argues that even in highly concentrated markets economic progress is possible, when few bigger firms are more likely to innovate than a large number of smaller firms (Metcalf, 2000).

To conclude, the description of the two concepts of competition illustrates that rivalry between supplying firms is a necessary condition of competition. In competitive markets rivaling firms strive for the patronage of consumers (Vickers, 1995). The theories of the Austrian School show that the process of rivalry is associated with an uncertain outcome. Thus, operating in competitive markets bears the risk to lose market share or being driven out of the market entirely. This leads to the necessity for suppliers to behave in a slightly different way in such markets, which in turn breeds more choice for the consumer. On the other hand, the neo-classical school illustrates that competition also means that the higher the number of rivaling firms in a given market, the more independent their decisions and the less likely the exertion of market power by individual firms. Monti (2007) points out that restraining competition to the process of rivalrous behaviour itself is "helpful in so far as we do not confuse means and ends" (p. 22). However, he argues that a thorough definition of economic competition must consider its effects as well. In this context the previous statements have shown that competitive markets are connoted with economic efficiency due to competitive pricing, product and production policies of suppliers.

### **3 Competition analysis - The Structure-Conduct-Performance paradigm**

#### **3.1 Theory**

In economics the characterisation of a market's competitiveness and functionality is primarily assembled in the theories and models of industrial organisation (IO). From the perspective of public institutions competition analysis is foremost concerned with the efficient allocation of existing resources and the implications for antitrust policies. From the firms' point of view competition analysis deals with the relative position of each rivaling supplier and their possibilities to earn substantial profits in imperfect markets (Jacquemin, 2000).

The traditional neo-classical approach to the study of IO, and thus the characterisation of competitive and uncompetitive markets, is the Structure-Conduct-Performance paradigm (SCP) (Caves, 1986). It analyses the operation of an industry in a market by distinguishing the three elements market structure, firm conduct, and industry performance and by evaluating their interrelations (Oz, 1995). The underlying hypothesis of the SCP paradigm is that a stable causal relationship between the three elements exists. The structure of a market is exogenous and conduct and subsequently performance are structurally determined variables. This means that uncompetitive market structures, such as a duopoly or monopoly, enable firms to exert market power by setting prices collusively or lowering the quality and quantity of their products

without becoming unprofitable. In such a situation firms are able to earn abnormally high profits, which in economic theory are a sign of inefficiency and a poor market performance (Monti, 2007). Competitive market structures on the other hand, coerce rivaling firms to set their prices independently to their marginal costs, thereby inducing economic efficiency (Fu, 2003).

Market structure consists of certain features of the market environment that influence the degree of rivalry between suppliers in the market, i.e. how competitive the industry is. Firstly, supplier concentration displays the number of rivaling firms in the market as well as the firms' market shares. Secondly, barriers to entry and exit are able to identify the potential number of competitors. The theory of contestable markets by Baumol, Panzar and Willig (Baumol, 1982) challenges the assumption that market shares of incumbent firms are the defining factor of market structure. Instead, in markets with no barriers to entry and exit – i.e. contestable markets, or ultra-free entry markets as Shepherd (1984) labels them – incumbents need to behave like competitive firms, since high prices and abnormal profits attract new providers. In business practice certain barriers such as economies of scale and absolute cost advantages of incumbents may impede the process of market entry. Barriers to exit principally define the sunk costs that an incumbent firm will face when leaving a market (Shepherd, 1984). Finally, the degree of product differentiation describes whether products in a defined market are homogeneous or heterogeneous. Competitive markets are marked by a higher degree of homogeneity (Caves, 1986). In general, the analysis of market structure allows for a definition of the market form (monopolistic, perfectly competitive, etc.) in which the firms interact.

Conduct in the SCP paradigm is defined as the individual firm's policies towards its product markets and towards the moves made by rivaling firms. In other words, it embodies the way in which firms in a given industry compete with each other. The main question is how firms set prices – collusive, independently or on the basis of consumer demand –, how they set the quality of their product, and which strategies they pursue to discourage entrants. In short, conduct is about the behaviour of the firms in a market (Jacquemin, 2000).

The third element is the performance of the whole industry which addresses the welfare aspect of the firms' interaction. Performance evaluates whether firms' interactions (conduct) lead to a socially and economically desired outcome, or whether government intervention is necessary. Although the economic literature does not give a completely uniform picture of what performance comprises, most authors associate it with a Pareto efficient outcome and thus with a social welfare optimum. Efficiency here contains allocative efficiency (are resources allocated in the best way possible), dynamic efficiency (do firms invest a proper amount of their resources in R&D), and productive efficiency (is the output of production maximised given the prescribed input). Furthermore, some economists relate performance to the question of whether the output of the industry corresponds with consumers' preferences and whether the outcome is equitable (Oz, 1995; Caves, 1986; Monti, 2007; Motta, 2004).

### **3.2 Criticism on the traditional SCP and modifications of the framework**

In the last five decades, harsh criticism has been passed on the conceptualisation and of the SCP paradigm. First, studies testing the causal relationship of the three elements have shown that under certain conditions social welfare can decrease when the number of firms is high. Therefore, the maximization of social and economic welfare is not monotonically related to a single element of the SCP, and in particular not to the number of firms operating in the market. Hence, there seems to be no ideal market

structure that leads to optimal performance (Britton, 1992). Moreover, critics argue that market structure is not an exogenously given factor, but depends on the efficiency of the individual firm. In contrast to the traditional SCP, the ‘efficiency-structure hypothesis’ assumes that market concentration can emerge from competition where firms with lower costs and higher productive efficiencies increase profits and market shares. Inefficient firms are driven out of these markets leading to a higher concentration (ibid., 1992). Both Tirole (1988) and Oz (1995) have criticised the SCP framework for its simplicity and straightforwardness in analyzing the complex relationship of the three elements. The links between them can only be regarded as correlations or as descriptive statistics, but not as causal relations. Finally, it is claimed that the SCP paradigm can only analyse static conditions and does not take into account that competition “is an evolving and historic process with possibilities of retroactions [...]” (Jacquemin, 2000, p.5).

As a result of this criticism, several studies in different industries distanced themselves from some basic assumptions, extended the framework by the specific conditions of the examined industries, or introduced alternative definitions of structure, conduct, and performance (Britton, 1992; Fu, 1995). However, Fu (1995) points out that these approaches have shown that there is the risk that the main point of what the SCP tries to convey is missed and the whole framework can become inoperable.

The criticism has also led to a new bias in the theory of industrial organisation. The SCP was the most important tool in US (and partially European) antitrust and competition regulation up until the 1980s (Oz, 1995). In modern competition research the simplistic assumptions about the behaviour of the firm and the unidirectional causality have been replaced by tools of microeconomic theory, models of imperfect competition, and game theoretical approaches (Bishop & Walker, 2002). Based on the assumption that market environment is not an external condition but can be created by strategic, sequential decisions of market actors, the ‘new industrial organisation’ allows for the analysis of dynamic competition settings instead of only static ones. Furthermore, new IO models have shown that price cuts are not always the ultimate response to more competition, rather it is noted: “More generally, with the various types of non-price competition, consumer welfare becomes more multi-dimensional and includes aspects such as the quality of the product and the speed and security of the supply [...]” (Jacquemin, 2000, p. 6).

### **3.3 Restrictions of an application of the SCP to rented housing**

The previous section has shown that industrial organisation has experienced a fundamental change with respect to its models and instruments, leading to a decreased importance of the traditional SCP paradigm. Nonetheless, Tirole (1988) and Oz (1995) note that the approach of the SCP can still be valuable: Evidence on firm behaviour and industry performance can be provided by detailed case studies. Based on this assumption and due to the framework’s straightforwardness and clear structure, we believe that an application of the SCP to rental housing markets will lead to a better understanding of how these markets work and how social housing and market housing are related. To be more precise, such an SCP can shed light on the questions what competition between different tenures in rental housing markets means, how it is expressed in reality, and how it can be evaluated.

The advantages of utilizing the SCP paradigm for rental housing markets are apparent: First, as stated in the introduction, the meaning of competition tends to remain implicit in housing studies that theorise on economic competition. By exploring the structure of rented markets, the role and behaviour of market actors, and the successive

performance, it will be possible to capture the various aspects of what competition in rented housing includes. Second, as was said earlier, housing policies have become much more market-oriented and politicians have claimed that rental housing markets and in particular the suppliers of social housing need to become more competitive. We would like to find out if a market-oriented, neo-classical framework can lead to different and more thorough insights about the characterization and functionality of contemporary rental markets. In other words, we would like to scrutinise whether a framework that has been predominantly utilised in commercial markets can better cope with prevailing forms of rental housing governance than the existing ways of analysing the relationship between social and commercial rented housing.

Nonetheless, we suggest that a simple application of the traditional SCP framework to rental housing markets is not reasonable: Indeed, the traditional SCP is too simplistic to explain the complex realities of (un-) competitive rental housing markets. The relation of the three elements should not be presumed but should be left open for systematic empirical examinations. Hence, we argue that when applying the SCP to rental housing it should be utilised as an organising framework rather than a biased model of competition analysis. Moreover, an application of the SCP to rented housing markets needs to consider that those markets differ significantly from the functionality and principles of conventional markets. For this reason, in a preceding step it needs to be clarified in what way rental markets are exceptional; i.e. how they do not cope with the assumptions of standard neo-classical models, and how this influences the conceptualisation of competition in those markets.

#### **4 Competition in rental housing markets – basic assumptions**

In general, rental housing is marked by certain key characteristics that we consider as crucial for the conceptualisation of our framework. First of all, rented housing has both investment and consumption attributes: The rented dwelling can be considered as an investment good which produces income for landlords. Rented housing can also be seen as a housing service for the tenants, which takes into account the physical quality of the dwelling, any locational condition (e.g. quality of surrounding schools and the environment) and the legal quality of the rental housing consumption (Barr, 1998).

Breaking up the product rented housing into these two categories has some general implications for competition in rental markets. Before the actual provision of a housing service takes place, landlords might compete for rental housing assets when they vie for buying existing dwellings or developing sites. One could also envisage a situation in which landlords compete in a tendering procedure for the provision of a housing service. Ultimately, landlords may strive for the patronage of the tenants when offering their housing services.

A second, and in our line of reasoning the most important characteristic of rented housing emanates from the possibility that local rented housing markets can comprise a market<sup>1</sup> and a social housing industry that build on different economic principles. We argue that the key distinguishing feature between the two industries is how the allocation mechanisms function, i.e. how the providers and consumers of housing services ‘come together’ (Haffner, et al., 2009; Oxley, et al., 2007).

---

<sup>1</sup> The term market in this context only refers to the way rented housing services are allocated. It is to be distinguished from an economic market in its broader sense, as presented in previous sections. Hence, if we speak of rental housing markets this may comprise both social rented housing and market rented housing. In other contexts market rented housing is also labelled as private rented housing. However, in this paper we prefer the former terminology since in some countries suppliers of social housing can be seen as ‘private’ organisations from a legal viewpoint.

#### **4.1 The economics of social and market rented housing in theory**

In theory, market rented housing is allocated by supply, demand, and the rent. The latter has the function to bring rented housing markets into equilibrium (Oxley, 2000). Although the motivations of individual landlords in practice might be different – in particular the motivations of institutional investors and small-scale individual landlords – providers of rented housing services are assumed to be profit-maximisers. Firms that do not follow this primacy face the risk of losing customers (Gilderbloom & Appelbaum, 1987). Consumers of commercial housing services are expected to be utility-maximisers. Accordingly, demand is governed by the willingness and ability to pay for the offered service. Prospective tenants that are not willing or able to pay can be excluded from the consumption of a market housing service (Oxley, et al., 2004).

Social housing, on the other hand, is not allocated by financial considerations of market actors (Oxley, 2000). Supply is not based on profit-maximising decisions as in commercial rental markets; rather it can be assumed that social housing providers are to a certain extent driven by their public tasks (Maclennan & More, 1997; Gibb & Nygaard, 2006). Demand for social housing services is not steered by tenants' ability or willingness to pay the rent, but by some sort of politically and socially defined and interpreted form of need (Oxley, 2000). Maclennan and More (1997) argue that the competitive market outcome produces only an insufficient amount of decent housing. Nonetheless, society might want all households to live under acceptable housing conditions. "There is, then, a gap between societally desired and effectively demanded housing output. This gap is often labelled [...] housing needs" (p. 535). It follows that the rent also has a different function in social housing markets. It is often prescribed by governments, meaning that it is restricted to a level well below the market rent.

Under the given definitions one might argue that competition between social and market rented housing is impossible. Providers in the two industries operate on different guidelines and their housing services are offered to a different set of tenants. In line with the applicability of the Structure-Conduct-Performance paradigm this would mean that the two industries could only be analysed separately.

#### **4.2 Housing political realities and their implications for competition between rental tenures**

Nonetheless, we argue that the given definitions of social and market housing are highly theoretical and narrow prescriptions of their actual functionality. The market rented sector seems somewhat competitive in the sense that local rented markets often consist of a large number of landlords which are primarily small in size. However, the commercial sector also displays some features of imperfectly competitive markets: On the one hand, landlords often have a better knowledge about the quality of their housing services than tenants do, leading to substantial information asymmetries. On the other hand, the offered housing services are highly heterogeneous and tenants' housing preferences are idiosyncratic. This induces high search costs for tenants and possibly high immaterial costs of moving, which in turn might enable landlords to set rents above a competitive level and thus exert market power (Gilderbloom & Appelbaum, 1987; Arnott, 1995). In many countries, particularly in Continental Europe, these imperfections are the rationale for market housing mostly not being a government-free zone. To be more precise, rent increases in the market sector are often not determined by market forces; rather they are regulated by what Arnott (1995) calls the second generation of rent regulation regimes. Rent regulation is often supplemented by extensive rules on tenure security. It follows that market rented housing is not per se



affiliated with a powerful position of landlords, but can resemble social housing markets in the way the relative positions of tenants and landlords are controlled by public authorities.

It also holds true that the theoretical statements about social housing do not necessarily cope with how it actually works in political, social and business practice. Since the principles of quasi-markets have found their way into various European social housing policies, the motives and aims of social housing providers have become more diverse (Gibb & Nygaard, 2006; LeGrand, 1991). The best example would be England where monopolistic state suppliers have in some cities been replaced by allegedly more competitive providers of social housing. Those providers can be either owned by local authorities, but have a degree of independence (Arms Length Management Organisations), or they can be privately funded (at least in part) and managed organisations (Housing Associations). Hence, England is an example for a social housing regime in which both public and private providers face hard budgets and are expected to work along more commercial guidelines (Gibb & Nygaard, 2006). Haffner, et al. (2009) pick up this thought and point out that the distinction between social and market housing providers generally has become more blurred in various European countries. Under certain models of social housing provision, profit-oriented firms can engage in the provision of social housing services (e.g. Germany, England). Social housing providers, on the other hand, may be authorized to offer housing services that generate substantial profits (which would have to be reused for the financing of social housing activities; e.g. the Netherlands, England).

Furthermore, it was outlined that the purpose of social housing, theoretically, might be the satisfaction of housing need, thereby focussing on housing services for low-income households and other disadvantaged tenants. However, housing policies in many European countries often assign a broader role to social housing. The social sector might also offer housing services to those households that given their income would be able to pay for housing services at market levels. In this scenario it seems that social housing plays the role of a socially integrating force, as it serves a wide spectrum of the population (Scanlon & Whitehead, 2007; Haffner, et al., 2009).

We suggest that these observations indicate that the two rental tenures are not necessarily 'worlds apart'. Obviously, the shift towards some market principles in the social sector and a pertinent regulation of market housing has led to two industries offering services that resemble each other in certain aspects. The assumption that social and market providers are assembled in two industries instead of one coherent industry still holds, because social and market rents perform a different function and social housing providers are bound to their public tasks (Scanlon & Whitehead, 2007). However, taking into account that the demarcation between market and social housing services seems to have become more blurred, it can be assumed that from the tenants' viewpoint those services can be seen as better substitutes. And if social and market services were seen as good substitutes, one basic condition of competition in economic markets would be fulfilled and the impossibility of competition between social and market rented housing would not hold anymore.

## **5 The Structure-Conduct-Performance of rental housing markets**

For the design of the SCP framework of rental housing markets the remarks made in section 4 are relevant in three ways: Firstly, the modified SCP framework of rented housing focuses on competition in the provision of housing services. Hence, rented housing is primarily analysed as the consumption good. However, we will also broach the issue of various landlords competing in tendering procedures in the different

production phases. Secondly, instead of analysing competition in one coherent industry, competition between the providers of two industries in one market is explored. Hence, in a modified SCP paradigm it needs to be made explicit that two industries exist and it should be analysed how they actually differ in their organisation and functionality. Thirdly, substitutability of the product (rental housing services) in the modified SCP needs to be assessed differently than it is done in the traditional application. The original approach relies on market and product definitions, as well as geographical limitations that assess substitutability in a preceding analytical step, thereby being exogenous to the framework (Motta, 2004). In contrast to that, substitutability of housing services is seen as an endogenous force and we argue that it needs to be assessed within the theoretical framework itself. This implies that the role of the consumer needs to be made more explicit; i.e., the tenants' influence on competition between the two tenures is considered more thoroughly.

The determination of geographical boundaries relies on the notion that housing markets are local entities. From the viewpoint of substitutability, rental housing services do not have a national or global component (Oxley, 2004). This needs to be considered in the modified SCP, which, then, should be applied to local housing markets rather than national entities. Ideally, an analysis of competition between social and market housing in local markets would rely on the concept of housing market areas (HMA), as applied by Jones (2002) for the Scottish home-owner market. The reason is that HMA are seen as "continuous areas comprizing a settlement or group of settlements with a high degree of housing market self-containment and where in-migration [...] is of only minor significance" (p. 557).

How the major modifications change the meaning of the three elements market structure, conduct, and performance is summarised in Table 1 and is described thoroughly in the following subsections.

Table 1: Comparison of the traditional SCP and the SCP of rental housing markets

SCP element	Traditional SCP	Meaning of competition	SCP of rental housing markets	Meaning of competition
<i>General assumptions</i>	Unidirectional causal relationship; uncompetitive market structures lead to poor economic performance. Supply-sided competition framework that is utilised in antitrust and competition policy.	Competition is primarily reflected in the market structure. Perfect competition seen as the best case. Hence, competition policy aims at changing market environment.	Utilised as an organising framework; possibility that there are two industries in one market taken into account; role of the consumer is made more explicit; supply-sided view of competition analysis is retained	Competition might take place between social and market rented housing suppliers. If so, it is reflected in all of the three elements. Seen as a state of affairs as well as a dynamic process.
<i>Market Structure</i>	Defines characteristics of the firm's market environment; determines the competitiveness of a market from three perspectives: Supply concentration, barriers to entry and exit, and product differentiation.	Allows for a definition of the market form and displays the general competitiveness of the industry. This is reflected in the number of firms and their market shares, the ease to enter the market and the offer's degree of homogeneity.	Defines the general characteristics of the rental market from the viewpoint of social and commercial rented housing. Market concentration, product differentiation and entry/exit barriers are examined to determine the degree of substitutability and potential competition between the two industries.	Competition as a state of affairs. The more similar the regulation and the less concentrated the supply in both industries, the more competitive is the whole rental market.
<i>Market Conduct</i>	Analyses the behaviour of the firms with respect to their product market and the actions taken by rivaling suppliers. Shows on which criteria (price, quantity, quality) firms directly compete and how they make decisions (independent, tacit, collusive).	Competition is seen as independent decision-taking, acknowledgement of risk to lose market share and the non-exertion of market power.	Analyses the behaviour of providers in both industries as well as the role and behaviour of tenants 1. Analyses if social landlords perceive market providers as rivals and vice-versa; how does this change their decision-taking (rent, quality, quantity)? 2. Examines whether tenants actually perceive social and commercial rental services as substitutes and how this influences their consumption choices and decisions.	Competition seen more from a dynamic viewpoint. Equated with the processes of rivalrous behaviour, acknowledgment of risk, independent decision-making, and tenants' exertion of choice.
<i>Market Performance</i>	Addresses the welfare aspect of the industry's general condition and the firms' interactions. Is the outcome economically (efficiency) and socially (equity, satisfaction of consumers preferences) desired or is intervention into the market necessary?	Competition is equated with the ends of (non-) rivalrous behaviour and an (un-) competitive market environment.	Performance evaluates the effects of a competitive relation of social and market housing: 1. Landlords- economic efficiency, impact of competition on business goals 2. Tenants – consumers' satisfaction, equitable outcome 3. Government – policy success or failure	Similar to the traditional SCP, competition is seen as the ends of a certain market structure and the conduct of landlords. In line with the whole framework, tenants and also public authorities get a more explicit consideration.

### 5.1 Market structure in rental housing services

In line with the traditional SCP in manufacturing or other service industries, market structure in the SCP of rental housing services framework consists of three main factors: Supply concentration, barriers to entry and exit and product differentiation.

Supply concentration in our theoretical framework differs slightly from its application in other industries. Despite that it also deals with the number of operating firms and their individual market shares in a defined market, and besides that it can be measured by one of the two standard concentration indices n-firm concentration ratio and Hirsch-Herfindahl-Index – for further information please revert to the extensive literature on concentration measurement (e.g. Tirole, 1988) – it is accounted for the possible existence of two industries in one market. Hence, assessing supply concentration for rental markets distinguishes between concentration in the social and the market housing industry. Table 2 shows that when the two industries are analysed separately, four different states of supply concentration can be identified. We assume that a market environment in which both industries consist of a high number of equally strong landlords is more competitive than a rental market where both, or one of the two industries are highly concentrated. However, it should be clear that the assessment of supply concentration is not sufficient to determine the general degree of competitiveness in rental housing markets. Rather, regulatory and financial aspects of rented housing markets need to be considered as well.

Table 2: Market concentration in rental housing markets

	<i>Market rented housing</i>	
<i>Social rented housing</i>	Competitive / Competitive	Competitive / Concentrated
	Concentrated / Competitive	Concentrated / Concentrated

Barriers to entry and exit in rental housing markets are important as they signify the stability of market supply concentration. Generally, this theoretical framework follows Arnott's (1995) argument that the common indicators of entry and exit barriers are negligible in rented housing: Economies of scale are rather low, incumbent landlords do not savour significant absolute cost advantages, brand loyalty is not as important as in other service industries, and leaving a market is not linked with disproportionate sunken costs. It follows that barriers to entry and exit are defined differently in the SCP of rental housing services, which again takes into consideration that two separate industries might exist. Accordingly, barriers to entry relate to the requirements and preconditions providers have to meet when they want to offer market or social housing services. The underlying supposition is that when bureaucratic burdens are low for a landlord to operate in both sectors, the market environment is more competitive than a situation where providers are bound to a strict regulation of the types of housing services they may offer.

We suggest that one entry barrier might be the access of landlords to subsidies in the provision of social housing. Here, we can revert to the idea of a contestable market: If all types of incumbent social landlords as well as other types of landlords are allowed to contest for the provision of social housing and associated subsidies, the rental market environment can be regarded as competitive since entry barriers to subsidies are absent. This directly relates to barriers to exit in rented housing. If the provision of market and

in particular social housing is a continuous engagement instead of a temporary process, one can assume that fluctuations in the supply structure will be relatively low and the market will be relatively static and uncompetitive.

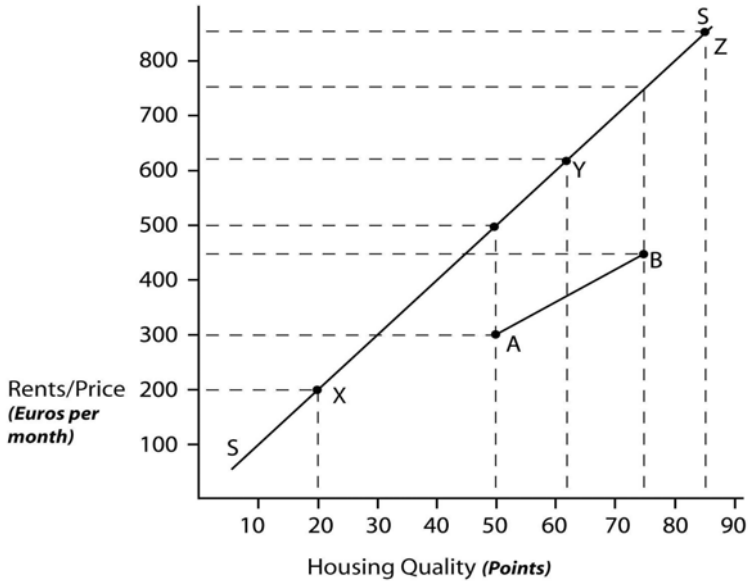
Another significant barrier to entry deals with the accessibility of landlords to tenants. If social (market) housing providers are only allowed to offer their housing services to a certain set of tenants, this may signify barriers to enter diverse market segments. To put it the other way round and taking the viewpoint of the tenants, barriers to entry then mean that the accessibility of tenants to the two industries is bound to certain criteria, meaning that tenants cannot choose freely between social and market housing services. In the social housing sector entry barriers might be explicit income limits or waiting lists for prospective tenants. Entry barriers might also exist in the commercial sector, when market landlords set up implicit income barriers and try to exclude households with lower incomes.

Product differentiation in rental housing markets can be related to the degree of similarity of the two sectors from a regulatory perspective. Through their social housing policies, governments are able to create distinct social and market housing industries, or they can implement a higher degree of similarity between them. In the latter scenario it can be assumed that tenants will perceive the two housing services as better substitutes, which would lead to a more competitive market environment. In our line of reasoning five factors are decisive for the degree of product differentiation:

- Differences in rent control policies, taking both initial rent setting and rent increases into account
- Types of landlords in the two industries, with respect to the way their operations are financed and (possibly) publicly funded
- The financial support for tenants, which considers the existence of distinct housing allowances in either sector
- The regulations of tenure security for tenants and further property rights in both sectors
- Differences in quality regulations, which comprises both quality standards of the dwelling and quality control of the landlords operations

In reality, the described regulatory framework directly relates to the differentiation of the offered housing services' price/quality dimension. For instance, rent regulation has a decisive impact on the price of a service, whereas property rights can be seen as crucial for the legal quality. It can be assumed that in those countries where social housing's purpose is to accommodate a broader clientele than just those in need, the aggregate supply curve of market services (SS in Figure 1) and the aggregate social offer curve (AB) are more likely to cover similar market segments than in countries where social housing does not have this purpose. If the curves do cover similar market segments, social and market housing services are more likely to be substitutes, inducing *potential competition* between all sorts of providers.

Figure 1: Theoretical rent/quality curves of social and market housing services



Assessing the three main factors of market structure allows for a characterisation of the general competitiveness of the rental market and provides an indication of which type of market form we are dealing with. Moreover, market structure helps to define the relation of the two rental sectors from a regulatory point of view, thereby determining the possible degree of substitutability of the two housing services. Competition is seen as a state of affairs which is based on, *inter alia*, rules of entry, structure of supply, regulations, and subsidies that in practice determine which rented housing is offered to whom in which locations. This in turn implies that in one situation a set of rules promotes competition between all kinds of suppliers and under another regulatory framework competition is forestalled.

**5.2 Conduct in rental housing markets**

Section 3 showed that market conduct in the traditional SCP paradigm analyses the behaviour of the firms, whereby it is assumed that a given market structure has a decisive influence on it. The behaviour of the firms consists of a firm’s policy towards its product market and towards the moves made by rivals. Accordingly, the SCP of rented housing markets analyses the behaviour of the landlords in the social and market housing industry.

As mentioned before, product differentiation in rental markets shows, among other things, which types of firms operate in which sector. It describes how they are funded and if they savour a beneficial legislation. However, product differentiation only forms the basis of the analysis of the firms’ behaviour. More important are the suppliers’ policies towards their product markets and towards the moves made by providers in the other industry. Thus, it might be less important which kind of organisational status firms in each sector have, but it seems more significant whether the providers of one industry perceive providers of the other industry as rivals for the patronage of customers and whether they face the risk of losing tenants to the other sector. This in turn implies that the existence of a rivalling social (market) industry might have an impact on strategic behaviour in the market (social) industry. The essential questions are whether rivalry and the perception of risk are transferred into the landlord’s decisions on rent, quantity, and quality setting and whether the decisions are made as independent landlords or whether landlords in both industries collude in their

decision-making. In other words, conduct in rental housing markets defines the degree of *actual competition* between the providers of social and market housing services. Theoretically, *actual competition* might be reflected in the movement of the market supply curve (SS in Figure 1) as a reaction to changes in the social housing offer curve (AB) (and vice-versa). An estimation of the relation and impact of the two curves on each other can add a more dynamic connotation to the definition of competition between social and market housing and thus does not only adopt the static tenet of the original SCP.

In contrast to the traditional SCP, conduct also gives significant weight to the role and behaviour of the tenants. As described above, product differentiation and entry barriers describe whether tenants, based on certain income criteria and government-implemented regulations, are able to rent accommodation in both sectors. In our line of reasoning we thus defined market structure, in particular the degree of product differentiation and entry barriers, as *potential competition*. If *potential competition* exists in reality as *actual competition* is, besides the behaviour of landlords, a question of the behaviour of the tenants. If the rental market environment is created as one competitive unit, the consequent question would be whether tenants do actually perceive certain price/quality bundles of housing services as good substitutes and most importantly, under which circumstances they are willing to substitute those bundles. This refers to choices tenants make and on which criteria they make these choices. To illustrate the case, behaviour of the tenants examines why tenants might be willing to choose the commercial housing bundle X in Figure 1 over the social housing bundle A, since from the point of view of a rational consumer the latter bundle seems to be strictly preferable.

In summary, competition in the conduct part of the SCP of rental housing markets can be regarded as a dynamic force that takes actions and retroactions of landlords and motivations in tenants' decision-making into account. Hence, it refers to the existence of rivalrous behaviour, the recognition of risk and uncertainty of operating in rental housing markets, independent decision-making in both industries, and the tenants' exertion of choices between social and market housing services.

### **5.3 Performance in rental housing markets**

In line with the traditional SCP performance evaluates the effects of competition between the suppliers in a market. More precisely, it is evaluated whether competition between social and market housing providers leads to a more efficient and productive delivery of housing services, or whether there is a positive (negative) effect on rent levels and the services' quality. Additionally, the analysis of performance in the SCP of rental housing markets needs to consider that competition might not necessarily be beneficial for the outcome of the housing service provision. Accordingly, from the viewpoint of the social housing industry, performance also determines whether competition with market suppliers has a negative impact on the delivery of their public tasks. This could, *inter alia*, mean that lower-income households might be marginalised, or investments into public spaces might be cut as a reaction to an increased cost pressure.

Besides an evaluation of the industry's performance itself, the framework assesses performance from two additional viewpoints. First, from a government's perspective performance shows whether the implementation of a housing policy that promotes competition between the two industries is successful or not. If those policies aim at the creation of separate industries providing housing services for a different set of tenants, then the existence of *actual competition* would indicate policy failure. If,

however, housing policies are designed to shape one integrated rental market, competition as indicated by the market structure or conduct of the market actors may suggest policy success. Therefore, performance and policy goals are clearly linked.

Second, performance can be considered from the consumers' perspective. A competitive rental housing market, in which the two sectors offer housing units that are good substitutes, means that tenants have more choice. If tenants have more choice and if they make use of the choice in their housing consumption decisions, one can assume that the outcome of rental housing allocation better satisfies the tenants' housing preferences. Efficiency on the other hand, is increased when choice of the consumers leads to the consumption of housing services by those providers that offer the best price/quality bundles. In such a situation resources are allocated to those providers that are able to deliver the best value for money services. Nonetheless, again it needs to be considered that competition might have negative side-effects: If competition with commercial suppliers induces social housing landlords to focus on more profitable market segments, then low-income households could be disadvantaged in competitive rental housing regimes and the rental market would be less equitable.

To sum up, competition in performance is equated with the effects of a competitive market environment and the behaviour of tenants and competitive landlords.

## **6 Assessing the links between the elements of the SCP of rental housing services – a comparative research perspective**

So far the SCP of rental housing has been solely considered as an organising framework. The three elements market structure, conduct, and performance have been seen as three separate components. At this, the framework has shown that each element adds a different note to the meaning of competition in rental housing markets that consist of a social and a commercial sector.

Nevertheless, it is not only essential to understand and analyse the individual impact of the three elements on competition between social and market housing separately, but it can be assumed that the three elements are interrelated and interdependent. Unlike the traditional Structure-Conduct-Performance paradigm the SCP of rental housing markets does not presuppose a unidirectional dependency from structure to performance; rather, we suppose that each element could have a direct influence on the other two (see Figure 2). For instance, it was outlined before that governments influence the structural relation of social and market rented housing through their housing policies. As a result, market structure is in reality almost never exogenous but strongly relies upon what public authorities want the rental housing market to represent and how it should function. In other words, it seems that an intrinsic theoretical link from performance to market structure exists. One could also expect that there might indeed be a link between market structure and the conduct of landlords and tenants. It is possible that differences in supply concentration influence the competitive behaviour of all firms, or how differences in the regulations of the sectors affect choices made by tenants.

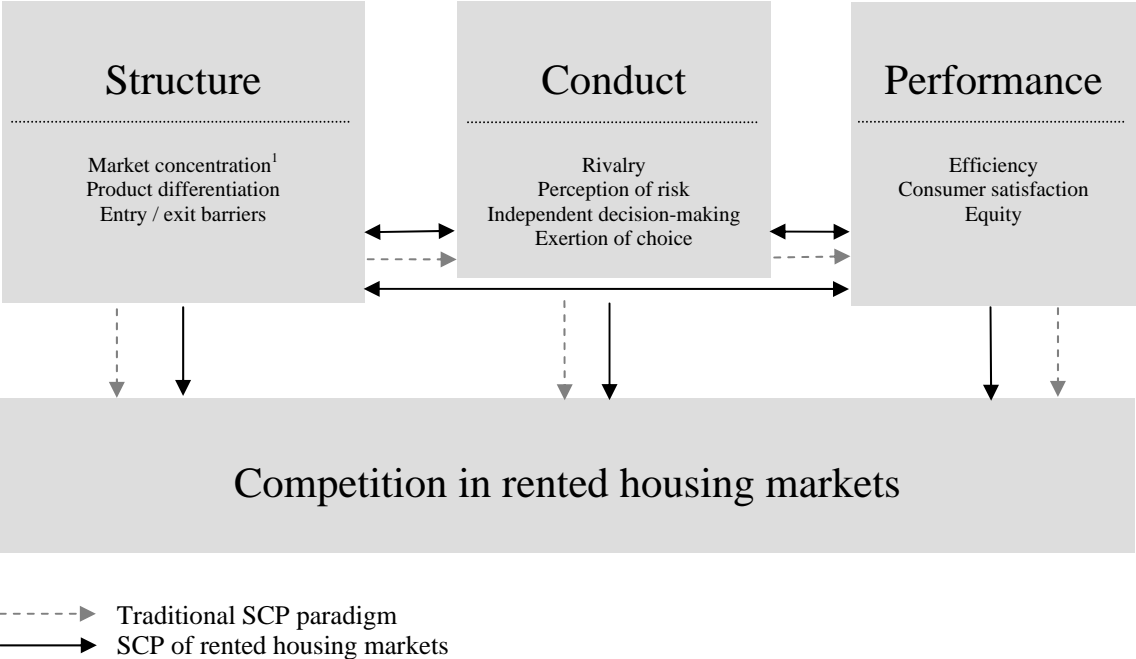
These two examples show that it is intuitive to assume differences between rental markets in all three elements when one element shows significant variations. However, as was claimed before, assessing theoretical links should not be presupposed but should be determined by a thorough explorative as well as explanatory investigation that does not only look for correlations in the relation of the three elements, but also tries to find causal factors. We believe that a good option to find these causal links between the elements is the application of the framework in an internationally



comparative approach. For example, the purposes of the two tenures and the organisational structure of different types of landlords differ across countries. This suggests that differences in behaviour and the three perspectives of performance exist as well.

On the other hand, examining the SCP of rented housing markets in different countries might not only provide unique insights of how competition between rented tenures functions and what it means. It might also be the other way round: A competitive paradigm that is placed in a central position in examining the relation of market and social rented housing across countries might help to understand the consequences of a society and economy that has been exposed strongly to market forces and mechanisms.

Figure 2: Comparison of the links between structure, conduct, and performance in the SCP of rented housing and the traditional SCP



<sup>1</sup>Please, bear in mind that the different factors (e.g. product differentiation, rivalry) composing structure, conduct, and performance can have different meanings in the two SCP paradigms (see Sections 3 and 5). In particular, exertion of choice is not a factor that is named in the traditional SCP.

## 7 Conclusion

Against the background that one can identify a lack of understanding around the concept of competition in rental housing markets, and in particular competition between social and market rented housing, this paper tried to establish a theoretical framework that might shed light on the various meanings of competition and how it can be assessed. In this endeavour we developed a framework that builds on conventional economic theories of competition and competition analysis in economic markets, namely the Structure-Conduct-Performance paradigm. It was shown that it is necessary to modify the traditional SCP in such a way that it is considered that competition takes place between providers of two industries instead of one cohesive industry and that substitutability of housing services is not self-evident.

We then argued that competition between social and market rented housing is reflected in the three elements of the SCP. Structure determines the static competitiveness of rental housing markets and the degree of substitutability (potential competition) of social and market housing services. Conduct defines the degree of actual competition as it assesses the degree of rivalry between social and market landlords, their independence in business behaviour, and whether they take notice of the risk to lose tenants to the other industry. It was also shown that by the choices they make about consuming market or social housing services, tenants play a key role for competition in rental markets. Furthermore, it was claimed that a complete definition of competition needs to take the effects of a competitive relation between social and market housing into account. It seems to be essential that not only the effects for the two industries themselves need to be considered. Accordingly, given the importance of the good housing for individual households, but also seeing it as one pillar of welfare states, performance also evaluates how competition in rental markets affects tenants and public authorities.

The final argument of the paper was that it needs to be acknowledged that there might be certain theoretical and empirical links between market structures, conducts, and performances. This in turn indicates that there exists a highly complex connection between the relationship of social and market housing on the one side and the functionality of housing policies and affected organisations and individuals on the other side.

At this point, it is important to emphasize that the suggested theoretical framework is not set in stone. There are some unresolved conundrums. These are primarily centred around the question of how the framework itself and also the links between the three elements can be operationalised. It might lead to remarkable problems when it comes to assessing the behaviour of tenants in the market. In this context the question arises whether one can expect tenants to be well-informed enough to be able to make intentional choices on rental housing services, as assumed by the theory. It seems that answering such a question is inherently difficult. Another major problem could be the assessment of the empirical links between the three elements of the SCP. Finding and measuring correlations might be a manageable task. Establishing causal links, however, needs much more thought than has been presented here.

To conclude, we think that applying the suggested framework in an international comparative research study is necessary to evaluate the quality of the theory itself and can also give some useful thoughts on how to improve the methodology and applicability of the SCP to rented housing services.

## 8 References

- Arnott, R. (1995): Time for Revisionism on Rent Control?, *Journal of Economic Perspectives*, 9 (1), pp. 99-120.
- Atterhoeg, M. & Lind, H. (2004): How does increased competition on the housing market affect rents? An empirical study concerning Sweden, *Housing Studies*, 19 (1), pp. 107-123.
- Barr, N. (1998): *The Economics of the Welfare State*, 3<sup>rd</sup> edition, Oxford University Press, Oxford.
- Baumol, W.J. (1982): Contestable Markets: An uprising in the Theory of Industry Structure, *American Economic Review*, 72 (2), pp. 1-15.
- Bishop, S. & Walker, M. (2002): *The Economics of EC Competition Law: Concepts, application and measurement*, Sweet & Maxwell, London.
- Britton, L.C., et al. (1992): Modify or Extend? The Application of the Structure Conduct Performance Approach to Service Industries, *Service Industries Journal*, 12 (1), pp. 34-43.
- Caves, R. (1986): *American Industry: Structure, Conduct, Performance*, Longmans, New York.
- Cave, M. (2007): *Every tenant matters: A review of social housing regulation*, London, Department for Communities and Local Government.
- Elsinga, M., Marietta H. & van der Heijden, H. (2008): Threats to the Dutch Unitary Rental Market, *European Journal of Housing Policy*, 8 (1), pp. 21-37.
- Fu, W. (2003): Applying the Structure-Conduct-Performance Framework in the Media Industry Analysis, *International Journal on Media Management*, 5 (4), pp. 275-284.
- Gibb, K. & Nygaard, C. (2006): Transfers, Contracts and Regulation: A New Institutional Economics Perspective on the Changing Provision of Social Housing in Britain, *Housing Studies*, 21 (6), pp. 825-850.
- Gilderbloom, J. & Appelbaum, R.P. (1987): Towards a Sociology of Rent: Are Rental Housing Markets Competitive?, *Social Problems*, 34 (3), pp. 261-276.
- Haffner, M., Hoekstra, J., van der Heijden, H. & Oxley, M.J. (2009): *Bridging the gap between market and social rented housing in six European countries?* Delft University Press (Housing and Urban Policy Studies), Delft.
- Hayek, F.A. (1948): *Individualism and Economic Order*, Chicago University Press, Chicago.
- Jacquemin, A. (2000): *Theories of Industrial Organisation and Competition Policy: What are the Links?* Working Paper, Forward Studies Unit, European Commission.

- Jones, C. (2002): The definition of Housing Market Areas and Strategic Planning, *Urban Studies*, 39 (3), pp. 549-564.
- Kemeny, J. (1995): From public housing to the social market: rental policy in comparative perspective, London, Routledge.
- Le Grand, J. (1991): Quasi-Markets and Social Policy, *The Economic Journal*, 101 (408), pp. 1256-1267.
- Maclennan, D. & More, A. (1997): The Future of Social Housing: Key Economic Questions, *Housing Studies*, 12(4), pp. 531-547.
- McNulty P.J. (1968) Economic Theory and the Meaning of Competition, *Quarterly Journal of Economics*, 82 (4), pp. 639-656.
- Metcalf, J.S. (2000): Competing Concepts of Competition and the Evolution of Competition Policy in the UK, Working paper, Workshop on Regulation and Governance, University of Philippines, March 2000.
- Monti, (2007): EC Competition Law, Cambridge University Press, Cambridge.
- Motta, M. (2004): Competition Policy – Theory and Practice, Cambridge University Press, Cambridge.
- Oz, S. (1995): Industrial Organization – Theory and Applications, MIT Press, Cambridge.
- Oxley, M.J. (2000): The Future of Social Housing: Learning from Europe, Institute for Public Policy Research, London.
- Oxley, M., et al. (2007): Competition and Social Housing in Europe, *Economic Affairs*, 28 (2), pp. 31-36.
- Oxley, M. (2004): Economics, Planning and Housing, Palgrave MacMillan, London.
- Priemus, H. (2008): Real Estate Investors and Housing Associations: A Level Playing Field? The Dutch Case, *European Journal of Housing Policy*, 8 (1), pp. 81-96.
- Scanlon, K. & Whitehead, C. (2007): Social Housing in Europe. In: Whitehead, C. & Scanlon, K. (eds.): Social Housing in Europe, London.
- Shepherd, W.G. (1984): “Contestability” vs. Competition, *American Economic Review*, 74 (4), pp. 572-587.
- Stigler, J.G. (1957): Perfect Competition, Historically Contemplated, *Journal of Political Economy*, 65 (1), pp. 1-17.
- Tutin, C. (2008): Social housing and private markets: from public economics to local housing markets, In: Scanlon, K. & Whitehead, C. (eds.) (2008): Social Housing in Europe II – A review of policies and outcomes, London.
- Tirole, J. (1988): The Theory of Industrial Organization, MIT Press, Cambridge.

Vickers, J (1995): Concepts of Competition, *Oxford Economic Papers* 47 (1), pp. 1-23.