Anti-Trust and Dominance

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Abstract

Through this paper, we aim to understand the various quantitative measures of dominance used across the world, and contextualize how these measures can be used in enforcing anti-trust laws better. A study of anti-trust laws in India has been done to trace the origin and transformation of the same. It begins by defining the concept of anti-trust and goes onto delineating the trajectory of these laws in the country, concluding with a collation of different metrics that should be used when measuring markets.

Introduction

In order to protect “free and unfettered competition” and the economic liberty that comes with it, the United States of America enacted the first anti-trust law, the Sherman Act, in 1890. Over the past century or so, Competition Law has come a long way, forming the basis of a neo-liberal economic system that seeks to advocate market-based economies with government intervention limited to ensuring that markets do not get monopolized. This is the exact mandate of anti-trust laws, which are enacted and enforced when threats of unfair business practices arise. These may include but not be limited to mergers and acquisitions that are threat to competition, abuse of dominant position or even penetrative pricing.

These laws are a fairly recent phenomenon in India, with the Competition Act coming into force in 2002 (replacing the Monopolies and Restrictive Trade Practices Act). A landmark shift in outlook was the movement away from curbing monopolies toward promoting competition, which was demonstrated in the new legislation. Under the aegis of the Act, several parameters to assess anti-competitive practices have been listed and demarcated, followed by preventive and retrospective penalties for violating said parameters. There exist a plethora of regional and national competition laws, however the most telling of our times are ones administered by the European Union and the United States of America. Although the economies are incomparable on several fronts, there are a variety of similarities in market structures of certain industries. It is essential that the regulation of these markets be compared to Indian regulation of analogous markets.

Objectives

- To qualitatively compare Competition Laws in India with their American and European counterparts,
- To trace the evolution of the Competition Act, 2002 and understand the inflections that shaped the present version of the act,
- To gauge levels of competition in specific industries so as to justify their regulation through said Competition Laws,
- To examine existing measures of dominance and saturation, and ascertain whether they are representative and useful when enforcing Competition Laws,
- To understand the correlation between research and development and enforcement of competition laws,
- To propose modifications to the aforementioned quantitative measurements.

History of Competition Law

"Strong competition policy is not just a luxury to be enjoyed by rich countries, but a real necessity for those striving to create democratic market economies." - Joseph Stigilitz

With the evolution of our intellectual capabilities, different things have begun to get more importance. From 'might is right' and 'survival of the fittest', we have come a long way. Some people might even believe in revolting ideas such as equal opportunity, protection of the weak and equitable distribution of resources. Antitrust laws were conceived from such evolutionary thoughts.

The earliest efforts to control price fluctuations and unfair competition can be traced back to the Indian and Roman empires. In around 50 BC, heavy penalties were imposed on those who tried to stop supply ships to protect corn trade. The study of competition formally began in the 18th century when Adam Smith introduced the concepts of restrictive trade practices, monopolies, acquisitions, trade restraints etc in the Wealth of Nations. The 19th century saw a number of laws being implemented in The United States Of America, popularly known as anti-trust laws, and in the United Kingdom, popularly known as Doctrine of Restraint of trade. These influenced the formation of modern competition law which begins The Sherman Act, 1890 and The Clayton Act, 1914.

At present about 90 countries have established competition laws. The OECD and UNCTAD make recommendations for the neo liberal business economy.

Competition is "a situation in a market in which firms or sellers independently strives for the buyers' patronage in order to achieve a particular business objective for example, profits, sales or market share" (World Bank, 1999). Competition Law is structured to promote and provide a fair chance for healthy competition between contending competitors in the market and to protect the consumer's interests.

Competition Law in India

Article 38 and Article 39 of the Indian Constitution mandate that the government creates shall secure and protect the society where people will get social, economic and political justice and it shall address all the organizations of the nation, and the State shall direct its policy as-

1. The ownership and control of material resources are so distributed as best to assist the common good;
2. The economic system does not operate as it creates a concentration of wealth and means of common detriment.

The Monopolies and Restrictive Trade Practices Act of 1969 was in consequence of the need to prevent concentration of economic power. From 1969 to 2003, the act made sure that there was no economic concentration of power much to its failure as the power was distributed on the basis of nepotistic whims.

It did not regulate the public sector, government undertakings, State Bank of India, etc which greatly restricted the scope of the act. Under the Nehruvian model, the public and private sector coexisted which allowed limited development in the private sector. The Industrial Policy Resolution of 1948 and 1956 emphasized on the state's role in economic development, growth and social justice which required the state to regulate command and control the private sector.

The Industrial (Department and Regulation) Act, 1951, allowed the government to control every aspect of the private sector. The private sector was only allowed a licensed capacity in the core industrial operations and the public sector was the driver of growth. This situation clearly favored the public sector as no other competitor was allowed to exist. If looked at from an objective point of view, this is against the foundation social justice. Not only were these 'Navratnas' unable to meet the demands of the growing population, they were centers of leakage, pilferage and rampant corruption. This is a likely outcome when competition is not allowed to exist. The spirit of healthy competition and the impetus to capture a larger piece of the pie guarantees minimum wastage and maximum output. The lack of competition festered lassitude and torpidity in the system. The 'make do' approach relegated India's progress. It was important that multiple players be allowed to exist in the same sphere. With the New Economic Policy of 1991 and New Industrial Policy of 1991, a new trajectory was followed for industrial development. The state continued to play an important role. Competition allowed the Indian economy to grow exponentially.

The licensing regime resulted in disproportionate growth of some businesses. The Monopolies Inquiry Commission also found out the product-wise monopolies existed due to large scale restrictive trade practices as a few business houses owned a large number of companies and managed to play the system. The MRTP Act was skewed in favor of the public sector undertakings. The private companies operating in the same sector were put at a great disadvantage which created an uncompetitive environment for them. This led to the decay of a lot of small scale businesses.

To minimize the limitations of the MRTP Act of 1969, the Government of India enacted The Competition Act of 2003. This act deals with anti competitive agreements, abuse of dominant position and a combination or an acquisition.

As a result of adopting the Structural and Stabilization Adjustment Programme, the government of India agreed to the General Agreement on Trade and Tariffs and Trade Related aspects of Intellectual Property Rights. The MRTP Act became less effective and obsolete.

The Raghavan committee was appointed to study the insufficiencies and inadequacies of the then policies and practices. The major recommendations were:

1. To repeal the MRTP Act and to enact a new Competition Act for the regulation of Anti-competitive agreements and to prevent the abuse of dominance and combinations including mergers;
2. To eliminate reservation of products in a phased manner for the Small Scale Industries and the Handloom Sector;
3. To divest the shares and assets of the government in state monopolies and privatize them;
4. To bring all industries in the private as well public sector within the proposed legislation.

The competition bill was introduced in 2000 to restrict monopolies and establish laws in synchronization with the established principles. The competition act received the assent of the president in 2003 and it thereby, replaced the MRTP Act. Under this new Competition Act, the Competition Commission of India (an expert administrative body) and the Competition Appellate Tribunal (quasi judicial to execute adjudicatory functions) were established.

The Preamble to the Act reads,

"*An act to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India…*"

The essential four components are:

1. It prohibits anti-competitive agreements like cartels, which restrict freedom of trade and cause consumer harm by way of limiting production and distribution of goods and service and fixing prices higher than normal;
2. It prohibits abusive behavior of a dominant firm, who through its position of dominance may restrict markets and set unfair and discriminatory conditions;
3. It regulates mergers and acquisitions of large corporations in order to safeguard competitive markets;
4. Mandates competition advocacy.

Measuring Dominance

This section of the paper aims at reviewing the various measures of anti-competitiveness, and assesses how they are used in different industries. From the outset, it is imperative to understand that these measures are not mutually exclusive and should be calculated and analyzed in tandem with one another – to corroborate results that have been achieved.

Using the European Court of Justice's definition of a dominant position - relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective

Competition being maintained on the relevant market by affording it power *to behave to **an appreciable extent** independently of its competitors, customers and ultimately of its consumers* – we can assess measures of dominance based on these criterion.

Even though market share has tended to be an informal way to gauge the degree of dominance in a market, several models prove that high market share may not necessarily result in monopoly power. One such model is Bertrand's duopoly, wherein both firms will have equal market shares however can exert no influence on market price and are completely reliant on the other firms actions.

Thus, to gauge monopoly power – and to gauge a firm's behavior independent of other factors, the ECJ uses three methods –

1) Cross price elasticity of demand
2) Cross quantity elasticity of demand
3) Price elasticity of demand

The first measures competitors' changes in price to a change in price by the firm under question, the second measures competitors' changes in quantity to a change in price by the firm under question and the final gauges the response of consumers to changes in price.

Mathematically, the three can be expressed as:

Define the elasticity of the rivals' prices (P) with respect to the firm's own price (p) by ρ:

$$\rho = (dP/P)/(dp/p)$$

rivals' quantity elasticity, μ:

$$\mu = (dQ/Q)/(dp/p)$$

Price elasticity of demand, ε:

$$\varepsilon = (dq/q)/(dp/p)$$

As all three values approach zero, we can conclude that the firm is operating independent of rivals and consumers – to an appreciable extent determined by the calculated values.

The lucidness of this measure is one that makes it attractive. It requires minimal data, all of which can be extracted in an unbiased manner. It, however, can only measure dominance. Anti-competitive practices such as parallel pricing will go undetected by these calculations, as the elasticity of price will be unitary – creating the illusion of independence whilst the movements are co-ordinated and methodical.

Picking from the several indices that exist, the Herfindahl-Hirschman Index and the Hause Indices will be analyzed thoroughly in this section, as they are the most potent measures of dominance and anti-competitiveness.

1) Herfindahl-Hirschman Index (HHI)

The HHI is a benchmark concentration ratio that can be mathematically represented as –

$HHI = \Sigma s^2$,

Where s is the market-share of a given firm expressed as a percentage.

The range of the HHI will therefore be: $0 < HHI < 10{,}000$.

It will be close to 0 in a perfectly competitive market, where firms control minute parts of the market, and will be 10,000 in the case of a monopoly, as the entire market is controlled by a single firm i.e. 100%.

In the American context, the HHI is calculated for a plethora of industries. If anomalies emerge from the given established framework (discussed below), anti-trust authorities step in. As per the 2010 DOJ – FTC guidelines, an industry is unconcentrated if the HHI is less than 1500, moderately concentrated if it is between 1500 and 2500, and highly concentrated if it is above 2500. Merger authorities, too, use this index to measure the extent of disruption caused by potential mergers. If there is a rise in the HHI by any more than 100 points in a moderately concentrated market, or a rise in any more than 200 points in a highly concentrated market – serious questions regarding monopoly power arise.

A common fallacy regarding the measure of market share in general is that it operates on an industry level – not on a service level. Take the instance of a hypothetical telecom industry with six major players, operating with market shares of around 15% each. Although there appears to be sufficient competition in the market, these six players specialize and control about 90% of the market in six completely different genres – say voice calling, video calling, high speed internet and instant messaging. Customers, therefore, are not beneficiaries of this supposed competition, as within the market there exist several schisms which are dominated. Measures of market share should therefore be a weighted average of a service's share of a firms dealings and the market share of that firm in that given service.

2) Hause Index

Using the Cournot model of oligopoly, Hause proposed an index that incorporates six different criteria, all of which he deems necessary to measure dominance. The biggest departure from other measures of study is the introduction of a parameter α, which measures the effect of collusion in a given oligopoly. Collusion and α share an inverse relation, with high levels of

collusion being represented by a small value of α. Hause numerically addresses how when n rises at a low level of α, competition increases at a slow rate. The formula of the index is as follows –

$$H_m(\alpha, \{s_i\}) = \Sigma\, s_i^{2 - (s_i(HHI - s))\alpha}$$

Quantifying the degree of collusion is a tedious process and must be a multifaceted approach. The elasticity measure may indicate collusion, however there is a possibility that those values are independent of any arrangements.

Conclusion

In the Indian context, there is no explicit mention of a specific measure of dominance that is used either priori or posteriori while firms are being investigated. The use of market share as a standalone measure is improper as it can be misleading. Firms with higher market share may not necessarily enjoy a dominant position, as abuse of dominant position is heavily reliant on the nature and composition of the market.

A standardized measure of market share, taking into account the concentration of the industry (measured by the HHI) would be a more accurate measure of the abuse of dominant position. It would provide legal authorities with a clearer understanding of the scenario.

It also must be ascertained as to whether or not a firm is creating barriers to entry in order to protect their position in the industry. Firms often indulge in practices such as limit pricing and predatory pricing, which is difficult to quantify. It is a binary as to whether this takes place or not, yet is an essential part of establishing dominance.

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