Renaissance of Economic-Efficiency through Competition Law in India

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***Abstract*—*The Indian economy underwent a paradigm shift owing to widespread economic reforms that were undertaken in nineties, moving away from 'Command and Control' economy to an economy dependent on free market principles; as a result the extant competition law regime governed by the Monopolies and Restrictive Trade Practices Act (MRTP Act) called for an overhaul in order for it to address the needs and challenges of the new economic paradigm. Therefore, the new competition law, competition act 2002 was enacted in 2003 and amended in 2007 for extracting the benefits of competition in post reform period. Competition in markets promotes efficiency; encourages innovation; leads to higher productivity; punishes the laggards; facilitates better governance; boosts choice, improves quality, reduce costs; ensures availability of goods in abundance of acceptable quality at affordable price. Given the benefits of competition and enactment of new competition law; the present paper focuses on explaining the need of competition law and increasing role of competition commission of India (CCI) for protecting all sectors of the economy from anti-competitive practices. Also, it uses creative investigation to describe the revival of Economic Efficiency through competition law after the economic reforms in 1991.*

Keywords*— *Competition, market power, economic efficiency, corporate governance, antitrust law, competition policy JEL Classification: D41, D42, D61, G34, K21

I. INTRODUCTION

Competition is the process of rivalry between business enterprises for customers. It is a fundamental characteristic of a flexible and dynamic market economy. By responding to the demand for goods and services at lower prices and higher quality, competing businesses are spurred to reduce costs, increase productivity, make investments and innovate in products and processes. As a result, both economic efficiency and consumer welfare are enhanced. The process of competition is, however, not automatic. The Chicago School, which is wedded to "Laizzez faire" philosophy, would have us believe that markets will regulate themselves. But perfect competition is as much as illusion as the perfect wife! Vested interest groups, large monopolistic firms and other stakeholders may distort the process of competition. This happens not only in emerging economies but also in advanced industrial economies. These market distortions not only adversely affect end-consumers but also business enterprises. Hence, there is a need for a robust competition policy and law. This is particularly important in a liberalizing economy where the government gradually withdraws in favor of private economic agents. As for Competition Law, it is the legal instrument designed to prevent anti-competitive business practices by firms. Effective competition policy and law put together are vital for a good regulatory and business environment.

II. COMPETITION AS PREREQUISITE TO ENSURE ECONOMIC-EFFICIENCY

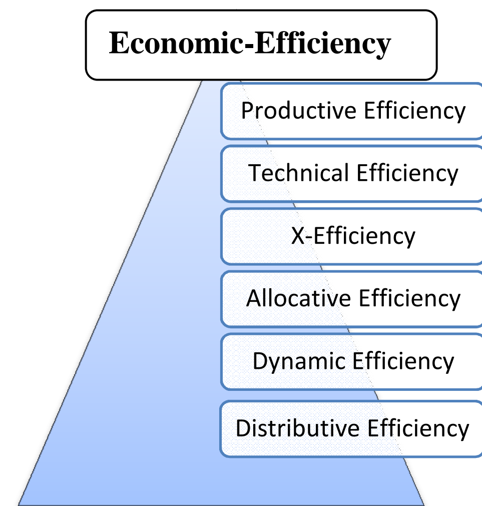
If we assume that a hypothetical economy has no government to regulate then the economy consists of producers and consumers. In standard microeconomic theory producers' welfare and consumers' welfare are measured by producer surplus and consumer surplus respectively. Producer surplus measures whatever the firm receives over and above its marginal cost. Consumer surplus represents the wedge between consumers' actual willingness to pay and what they actually end up paying i.e. the good's price. The aggregate of these two surpluses is a quantitative measure of economy's gross welfare. Economic efficiency ensures that resources are so allocated such that aggregate welfare is the highest. Any market imperfection which leads to market failure also results in a deadweight loss which is a quantitative measure of the benefits foregone by not attaining economic efficiency. In a typical market economy no single agent can maneuver prices because of limited market power. Prices are determined in the market through the interaction of demand and supply and it corresponds to equilibrium where supply is fixed (**Marshall, 1920**). On the one hand, consumers with their limited income seek to maximize their satisfaction and on the other, producers' desire to maximize profits compels them to reduce costs and increase productivity by adopting innovative technology. "A properly functioning market system would tend to stimulate both economic efficiency and economic growth. And it is important to note that the market does this automatically, while it

requires no big administrative apparatus, no central decision making, and very little policing other than the provision of a legal system for the enforcement of contracts." All the three conditions of economic efficiency elaborated in the previous section can be achieved in a perfectly competitive economy and this is called the first theorem of welfare economics. All producers pay factors of production according to the value of their marginal products. In other words, prices equal marginal costs. Consumers equate MRS of a pair of goods with respective relative prices. Finally, market clears with no excess demand. In the long run each firm operates at the lowest average cost. Thanks to free entry of firms who are lured by above normal profits earned by existing firms in the short run. **Adam Smith (1776)** described this process best: "Every individual endeavors to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it." However, whether competition promotes technical efficiency remains questionable **(Schwartzman, 1973)**. To avoid conceptual muddle, **Leibenstein (1973)** calls unobservable technical efficiency X-efficiency which "involve internal organizational problems." In sharp contrast to the argument put forward by Schwartzman (1973) he showed how competitive outcome is superior to monopoly outcome even in terms of the "degree of X-efficiency." **Hay and Liu (1997)** based on an empirical study of UK manufacturing firms, concluded that "long run efficiency is related to investment by the firms, suggesting that in a more competitive environment the firm has not only a strong incentive to improve its efficiency performance (increased market share and higher profitability), but also the means (investment) to do so…Short run improvements in efficiency resulted, probably the result of managerial effort; and these improvements were larger the greater the improvements achieved contemporaneously by rival firms." Having said this it seems a market economy never fails to attain efficiency. But that is not always true.

From the above discussion we can say that Economic efficiency is a situation in which

- No one can be made better off without making someone else worse off (commonly referred to as Pareto efficiency).
- No additional output can be obtained without increasing the amount of inputs.
- Production proceeds at the lowest possible per-unit cost.

Competition ensures different types of Economic-Efficiencies:



- **Productive Efficiency**: This occurs when the maximum number of goods and services are produced with a given amount of inputs. A firm is said to be productively efficient when it is producing at the lowest point on the average cost curve (where Marginal cost meets average cost). Productive efficiency is closely related to the concept of Technical Efficiency.
- **Technical Efficiency**: Technical efficiency is the effectiveness with which a given set of inputs is used to produce an output. A firm is said to be technically efficient if a firm is producing the maximum output from the minimum quantity of inputs, such as labor, capital and technology. The concept of technical efficiency is also related to X-inefficiency.
- **X- Inefficiency:** This occurs when firms do not have incentives to cut costs, for example a monopoly which makes supernormal profits may have little incentive to get rid of surplus labor. Therefore, a firm average cost may be higher than necessary. When there is this lack of incentives, the firm will not be technically efficient. X Efficiency would be when competitive pressures cause firms to combine the optimum combination of factors of production. Causes of X Inefficiency:

➢ Monopoly Power/ No Competition: A monopoly faces little or no competition. Therefore, it might be easy for the monopolist to make supernormal profits. Therefore, in the absence of competitive

pressures, they may not try very hard to control costs.

- State Control: A nationalized firm owned by the government may face little or no incentive to try and make profit. Therefore, it has less incentive to try and cut costs.

- **Pareto Efficiency:** If we can find a way to make some people better off without making anybody else worse off, we have a Pareto improvement. If an allocation allows for a Pareto improvement, it is called Pareto inefficient; if an allocation is such that no Pareto improvements are possible, it is called Pareto efficient. Pareto efficiency is however, a situation where resources are distributed in the most efficient way. It is defined as a situation where it is not possible to make one party better off without making another party worse off. Pareto efficiency is related to the concept of productive efficiency. Productive efficiency is concerned with the optimal production of goods which occurs at the lowest point on the short run average cost curve. Pareto efficiency is also concerned with allocative efficiency. To be Pareto efficiency the distribution of resources needs to be at a point where it is impossible to make someone better off without making someone worse off.
- **Allocative Efficiency**: It occurs when the price of the good is equal to the marginal cost of production. This is because the price that consumers are willing to pay is equivalent to the marginal utility that they get. Therefore, the optimal distribution is achieved when the marginal utility of the good equals the marginal cost.
- **Static Efficiency**: is concerned with the most efficient combination of resources at a given point in time. Static efficiency has two aspects. The first is that there is maximum output of goods given the volume of resources in the economy. Second, the goods produced must be a preferred combination. That is, these should reflect not only technical possibilities but the preference of consumers as well. Static efficiency is also concerned with allocative efficiency. However, in addition to a static concept of efficiency, there is also a dynamic efficiency.
- **Dynamic Efficiency**: This refers to efficiency over time. Dynamic efficiency involves the introduction of new technology and working practices to reduce costs over time. With this mind, we can define dynamic efficiency as an aspect of economic efficiency that measures the speed or the rate at which the production possibility curve moves from one static equilibrium point to another within a given period.
- **Distributive Efficiency**: Concerned with allocating goods and services according to who needs them most. Therefore, requires an equitable distribution. Distributive efficiency occurs when goods and services are consumed by those who need them most. Distributive efficiency is concerned with an equitable distribution of resources because of the law of diminishing marginal returns. The Law of diminishing marginal returns states that as consumption of a good increase we tend to get diminishing marginal utility. A monopoly could lead to distributive inefficiency. A monopoly is able to use its market power to set high prices and make super-normal profits. Thus a monopoly owner can gain a higher share of national output, but consumers face higher prices and a decline in consumer surplus.
- **Social Efficiency**: is the optimal distribution of resources in society, taking into accounts all external costs and benefits as well as internal costs and benefits. Social Efficiency occurs at an output where Marginal Social Benefit (MSB) is equal to Marginal Social Cost (MSC). Thus, social efficiency occurs when externalities are taken into consideration and occurs at an output where the social cost of production (SMC) is equal to the social benefit (SMB). Social efficiency is closely related to the concept of Pareto efficiency.

III. COMPETITION LAW AND ROLE OF COMPETITION COMMISSION OF INDIA

Competition law is a law that promotes or seeks to maintain market competition by regulating anti-competitive conduct by companies. Competition law is implemented through public and private enforcement. The Competition Act provides a formal and legal framework to promote and sustain competition through its various provisions which, inter-alia, includes-

• Prohibition of anti-competitive agreements at horizontal and vertical level which restrict competition and are harmful to consumers by way of market allocation, limiting production and formation of cartels.

• Regulation of abusive behavior of dominant player in relevant market which may resort to unfair and discriminatory conditions, distort competitive structure of the market and compel consumers to accept their terms and conditions.

• Regulation of mergers and acquisitions that cross the prescribed thresholds, to safeguard competition in markets.

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The Competition Act, 2002, as amended by the Competition (Amendment) Act, 2007, follows the philosophy of modern competition laws. The Act prohibits anti-competitive agreements, abuse of dominant position by enterprises and regulates combinations (acquisition, acquiring of control and M&A), which causes or likely to cause an appreciable adverse effect on competition within India. The objectives of the Act are sought to be achieved through the Competition Commission of India (CCI), which has been established by the Central Government with effect from 14th October 2003. It is the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade in the markets of India. The Commission is also required to give opinion on competition issues on a reference received from a statutory authority established under any law and to undertake competition advocacy, create public awareness and impart training on competition issues.

IV. CCI AND REVIVAL OF COMPETITION CULTURE IN INDIAN ECONOMY

The Competition Commission of India (CCI), which was formed after the Competition Act came into existence on March 31, 2003, following the repealing of 30-year-old Monopolies and Restrictive Trade Practices Act of 1969 (MRTP ACT), has hogged the limelight of late for both right and wrong reasons. Most recently it imposed a penalty of Rs 1 crore on **Google** for failing to comply with the directions given by its investigating arm— seeking information following allegations that Google favors its own products in search results and resorts to discrimination by favoring paid searches. As competition regulations mandate violators to be slapped with penalty of up to ten percent of their three-year annual average turnover, Google may have to shell out as much as $5 billion, considering its annual revenues in the last three years amounts to over $50 billion. Previously, it also slapped varying amounts as fine on the **Board of Control for Cricket** in India (BCCI) for tweaking IPL franchise agreements in its own favor; the **National Stock Exchange** (NSE) for abusing its dominant position in the currency derivatives market; and **DLF**, the country's largest realtor by market capitalization, for abusing its market-leading position by drafting one sided agreements with property and home buyers.

CCI, which became fully functional in 2009, effectively reflects a legislative shift from the binding mindset that prevailed at the time of License Raj to new conducive regulatory ambience for enhancing consumer welfare by sustaining and encouraging competition in the market.

It also functions as a means to support sector-specific regulatory bodies as the role of state as proprietor gets diminished across industries, especially utility and infrastructure, and private participation and ownership increasingly become the driver of economic activities, to ensure a level-paying field for all market participants.

A key objective of CCI is to ensure that key players do not abuse their dominant position to involve in anti-competitive activities by using collusion or cartelization to gain control and market share in specific spaces. In fact, the Competition Act clearly prohibits anti-competitive agreements, abuse of dominant position by enterprises and regulates combinations via mergers and acquisitions that may hurt competition. CCI is also expected to protect the interests of consumers and ensure freedom of trade in the market in addition to eliminate practices that curb competition. In addition, it is mandated to work in tandem to carry out competition advocacy. CCI has been probing several sectors especially real estate, entertainment, cement, petroleum, steel, travel industry, healthcare and education to nip anti-competition practices and strategies of a varied bunch of players. In 2011, it had 58 pending cases which were reduced to 20 by July 2012. Currently, it is reportedly looking into 39 cases of violation of anti-competitive norms under the Competition Act. To effectively implement its mandate, it has been granted robust powers in terms of enhanced authority, penalizing provisions and a dedicated appellate authority. Armed with enhanced muscle power, it is expected to help transform India into a market place on par with more mature markets like the US where anti-competitive legislations seems to have come of age. Therefore, we can say that there is revival of Economic-Efficiency through competition law in India. However, there have been concerns regarding the validity of CCI as there have already been industry-specific regulators and if its enhanced authority may force it to infringe upon the functional terrain of other regulatory bodies including the RBI and SEBI.

Also, there have been criticisms that in many cases, the penalty imposed by CCI is excessive against the backdrop of lack of defining guidelines for arriving at the appropriate amounts.

On the other hand, once CCI manages to iron out the glitches that seeped into its functioning and start using sophisticated economic tools for investigating regulatory violations, it should be able to lead India to an era of enhanced anti-competition practices that will further enhance the country's status as a market that is fast approaching maturity in terms of regulations.

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Given the continental size of the country, its large and disparate economy and, above all, weak 'competition culture', it is no easy task to monitor and identify the anti-competitive conduct of enterprises and correct them by prescribing appropriate remedial measures.

The provisions of the Competition Law also do not allow the CCI to apply its resources as per priorities set by it. Nevertheless, the CCI tries to priorities suo moto action, keeping in mind the more visible and direct impact on the lives of a vast number of people (e.g., sectors such as pharmaceutical retail).

Competition enforcement all over the world is seen to be a major contributor to the development of fair and competitive markets, and therefore economic growth. In India, competition jurisprudence is at a nascent stage, but strong foundations have been laid by the CCI. This is being well supported by the highest court.It will be the endeavor of the CCI to enforce competition law through a judicious mix of wise and effective enforcement backed by widespread advocacy among stakeholders to foster a competition compliance culture in the country.

V. CONCLUSION

A robust and fair competition culture accelerates economic growth, which in a liberalized economy in turn benefits the consumers. An effective competition law and policy promotes both allocative and productive efficiencies. This results in continuing incentives for innovation to increase productivity, and consumers benefit from lower prices, better quality and a greater variety of goods and services. Adopting the twin strategies of enforcement and proactive advocacy the Competition Commission of India (CCI) has endeavored to create a competition culture by curbing anti-competitive practices and disseminating information and imparting training to various stakeholders. To infuse the confidence in consumers Commission has imposed penalties in cases/ information filed before it and has also taken suo moto cognizance where it found consumers' interest have been undermined through anti-competitive practices. Having a good law is not enough. The introduction of a competition law needs appropriate supporting policies, and effective enforcement. Government must show support for market economies and must recognize adequately the impact of other legislation and regulations on competition. The design of an appropriate national competition policy must keep local realities in mind, and give sufficient weight to governance capabilities and institutions and to political realities that will often include the presence of small and frequently vulnerable domestic markets. To be fully effective, a competition policy must be supported by a "culture of competition", where the objectives of competition are widely understood and form a natural part of the background to decisions by government, firms and consumers. Civil society and a vigorous consumer movement in particular, can play a constructive and valuable role in the development of a culture of competition. Vested interests that oppose reforms and fair competition have to be overcome. An open media and an informed judiciary are needed if competition policy and law are to be fully effective. Above all, politicians must be committed to wanting to make markets work well, to ensuring that the government's responsibilities to markets are well understood and to help build the technical capacity needed for this task. Also, where competition policy is part of an open and well-regulated economy, it can help encourage both domestic investment and FDI, because it encourages investor confidence by setting a consistent framework within which the business sector operates. An effective competition policy allows innovative new entrants an important role in the development process, and promotes growth. Moreover, an effective competition reduces opportunities for corruption and rent seeking, and creates more space for entrepreneurs and small and medium sized-enterprises.

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