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An Economic Insight to Competition law of India

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Abstract

Economics is a stately subject so much so that every nation's economy has its own complexities. Every economy is subject to idiosyncrasies. The aim to be achieved through the competition law should although be complying with the international best practices but keeping in mind the specificities of our economy. Keeping pace with the evolving market economy and new economic theories coming into the field, the Competition Commission of India (Commission) at this point in time requires devoting chief importance to the doctrine, convention and criteria that should support the functioning of the various provisions of the Competition Act in the context of India.The objective of this paper is to assess the significance of applying specific economic facets to the conduct of entities within the scope of Section 4 and to explore what kind of approach would be more suitable to the Indian regulatory environment: per se or rule of reason.

Keywords: Competition, Price Discrimination, effects based approach, form based approach

Introduction

Section 4 of the Indian Competition Act talks about the prohibition of abuse of dominance. There can be majorly two kinds of approaches to consider the cases falling into this category.

One is the per se or the intent based approach, known as the form based approach under which *there is no obligation on the authority to assess the circumstances under which the practice has taken place and the results that certain practice could have on the market and consumers*(Bhatia), rather the authority just checks for the conduct or the intent of the firm neglecting the effects of that conduct. It is an ex-ante approach of the description of conducts which are banned

On the other hand is a more comprehensive and economic approach known as the effects-based approach which focuses on the presence of anti-competitive effects that harm consumers, and is more case specific backed with sound economic facts. With the modern economic theories such as those proposed by the Chicago School, there is a growing realisation in the cases of abuse of dominance to assess the effects of the conduct on the competition rather than just showing the anti-competitive behaviour or the intent of the entity.

Section 4 vs. Section 3

Section 4 of the Indian Competition Act, 2002, focuses on the prohibition of abuse of dominant position by an enterprise or group is worded in ways that inherently follows an intent based or per se approach whereas Section 3 follows an effects-based approach. On one hand, although the act talks about the appreciable adverse effects of an anti-competitive agreement in Section 3 and only in the presence of such effects are the practices penalized, there is no mention of such effects in Section 4.It rather stresses on the form of the conduct.

The finding of the abuse of dominance requires a guided three step-process as per the legislation which is as follows:

1. To find out if the party in question complies with the definition of Enterprise or a group as per section 2(h)

2. To determine the relevant product and relevant geographic market and to find out if the firm in question is found to be dominant in that relevant market.

3. To check if the firm indulges in any abusive practice as per Section 4.

Further to assess the position of dominance in the relevant market, the Act specifies certain factors as follows under section 19(4)"

(a) Market share of the enterprise;
(b) Size and resources of the enterprise;
(c) Size and importance of the competitors; etc.

Going through these factors, the Act implicitly points that the legislature mandates the adoption of "Rule of Reason" approach in deciding the position of dominance under the Act. But there is no clear mention under the Act as to what approach has to be followed while considering the alleged abuse of dominance.[1]

Having said that, the Section concerning the prohibition of abuse of dominance being worded in a way that it seems to be following a form-based approach, if stressed and read more carefully, the presence of words such as "unfair" itself points to questioning the conduct's effect and hence if found to be distortionary to be put under the ambit of "unfair" condition/prices. To categorise a certain conduct to be unfair, one has to look into the effects to decide the unfairness of the practice which is not very clear by reading the Act.

So, whether the Section inherently follows a form or an effect based approach is still into questions. The Act has a subjective comprehension. On one hand, since there is no mention of any term such as *appreciable adverse effect* in Section 4 as it is in Section 3, it is believed that the Act subsumes that Section 4 follows a form-based approach while at the same time on the other hand, inclusion of word such as "unfair prices/conditions" puts questions on its possibility of following a form-based approach.

Goals of a Competition Policy:

Amongst the goals of competition policy, two goals which have been majorly debated are Total-welfare or, a consumer-welfare standard. In other words, a question of productive and allocative efficiency needs to be catered to while framing a competition law.

Productive efficiency refers to the ability of a firm to produce output by expending the least on the inputs/factors of production.

Allocative efficiency/Static efficiency, on the other hand, refers to the pare to optimality concept which says that a pareto-optimal criterion is fulfilled if no person can be made better off (in terms of its utility) by making some other person worse-off. In terms of general equilibrium theory of efficiency, competition is an instrument that can bring about allocative efficiency. Hence, in

[1] "Need for Adoption of the Effects-Based Approach by the Competition Commission of India" by G.R. Bhatia,Advocate,Partner and Head of Competition Law Practice,Luthra&Luthra Law Offices,New Delhi

accordance with the welfare-economic theories, in case of any trade-off between competition and efficiency, a decision should always be made in the favour of efficiency.

Dynamic efficiency on the other hand talks about the long-run growth of the economy and concerns the innovative dimension of competition. Uncertainty and unpredictability of the innovation process makes it impossible to judge the outcome of the research ex -ante. Hence the general equilibrium model doesn't consider the dynamic efficiency which is a novel concept with the innovation emerging in the markets and developing economies.

Thus, in an ex-ante approach (form-based)as that of general equilibrium model, the concern for dynamic efficiency is often ignored and hence necessarily even in the presence of question between the goals of competition policy, there is a need to enhance and concentrate on the long-run efficiency for a growing economic, hence calling in for an approach (ex-post) which would consider the intertemporal benefits and working on the cost-benefit analysis could judge the impact to be prohibitory or not. All this is tough to be achieved in a per-se rule.

Measuring the Pros and Cons

Effects based Approach

- Difficult for entities to circumvent competition policy when the focus is on the effects rather than the conduct. Entities can sometimes involve themselves in other commercial practices which are not considered to be anti-competitive by looking at their intent but leads to the same effect any considered anti-competitive conduct would lead to. Hence, considering the outcome or effect of the conduct leads to consistent treatment of different practices leading to the same anti-competitive effect.

  For example, Excessive pricing (above cost) can have exclusionary effects in medium to long run although the intent is not questioned under the competition law but it might lead to just similar exclusionary effects which might occur under predatory pricing which is considered to be an anti-competitive practice by intent. Suppose there is a dominant player in the upstream market and the same player enjoys a dominant position in the downstream market also, then if the upstream player prices excessively above the marginal cost, it might just lead to exclusion of other downstream rivals for whom purchasing the same product at a higher price might pose greater losses as compared to the dominant firm in the downstream market. Hence, in this case, excessive pricing leads to exclusionary effect although the intent is not questioned in the Competition law.

- A similar practice may have competitive or anti-competitive effects depending on the circumstances. Substantiating this with an example, sometimes prices charged below cost (technically termed as predatory pricing and are prohibited under the Competition law) may come under "normal " competitive pricing in circumstances such as pricing done when the firm enjoys economies of scale or pricing done when the firm faces the positive learning effect.

- Makes the decision making power of the competition authority more complex and requires more research resources.

Form based Approach

- Ease in Enforcement.
- Cost-effective: as not much of research is required and no addition analyses for different cases are mandatorily required.
- Transparency: By setting out set penalties for defined conducts and not giving economic justification for individual situations, the judgement becomes transparent as the law is applied as stated without mentioning the effects and claiming the conducts to be punishable.

- Predictability under the "ex-ante" (form-based) analysis of the competition law may hinder innovation and hence economic growth.

- This might just lead to many type I errors and type II errors[2](false positives and false negatives) i.e. neglecting the efficiencies generated by the conduct that might appear anti-competitive by form and hence leading to over-inclusion of cases which by form seem to be anti-competitive but in fact leads to efficiencies resulting in fostered consumer welfare.

Price Discrimination:

This subject has been comprehended quite differently by a lawyer and by an economist. The "exploitative" effect of the practice makes the lawyers suspicious with regard to discrimination but it can actually have ambiguous effects on the welfare which would be analysed in greater detail in this section. According to Section 4(2) (a) (ii), the Competition Act declares the abuse of dominance when a firm, directly or indirectly imposes unfair or discriminatory price in purchase or sale of goods or service. Hence price discrimination, in any form (until it is made to meet the competition), is prohibited under the Competition Act but it may not always lead to abusive effect. To judge whether the discrimination is to meet the competition or to affect competition, one has to look into the broader picture by the detailed analysis of each specific case.
However, more recent analysis shows that price discrimination can sometimes lead to increase in total welfare (it always leads to an increase in the dominant player's welfare) and even consumer welfare.

Pro Competitive Effects of Price Discrimination:

- Illustration 1: Consider a firm incurring huge sunk investment and there are consumers in the market whose willingness to pay for the product is lower than the equilibrium price of the market, for example, hence allowing the firm to cater to the previously excluded segments of consumers by the act of discrimination of prices will mean a larger profit for the firm, thus, acting as a source of return to those investments. Now it can charge the excluded segment of consumers a lower price by discriminating price (because their willingness to pay is low) whereas in case of uniform pricing, these customers went excluded from the market because their willingness to pay was lower than the actual prices. These extra returns might encourage the firm to invest more in the future, increasing the output produced and hence inducing pro-competitive effects in the market. With price discrimination, the firm gets the extra surplus which would increase its incentives to invest more and hence of interest for all. If dynamic incentives are taken into account as well, price discrimination may ensure that

[2]Type 1 Error: Mistakenly prohibiting pro-competitive practices, also known as false positive.
Type 2 Error: Mistakenly permitting anti-competitive practices, also known as false negative.

long-run incentives to invest (e.g. in R&D) are preserved by providing firm with sufficient returns[3]

Increase in consumer welfare:

There is an output expansion and low-end consumers can now avail the good. Even the customers who were paying higher prices in this case are benefitted from this kind of price discrimination because in the next period or for that matter even in the same period, goods are being made available to the high-end customers because of their investments.

Hence, the tags of 'fair' and 'unfair' prices should be re-considered as the prohibition of 'unfair' pricing to the customers paying higher (here) may actually seem to be making them worse-off.

Having said all this, the impact of price discrimination on consumer welfare is highly dependent on the consumer demand, in this case.

Also, dynamic efficiency should be kept in mind while analysing the effect of price-discrimination, i.e. the consumers can benefit in the future even while it makes them worse-off today, like in this case, if incentives to invest are negative for the firm, consumers may lose in the long-run.Hence, a cautious approach should be taken into account while studying the impact of price discrimination which is tough to be warranted in the per se approach.

Price discrimination can, in some cases bring efficiency and benefit consumers even when firms have significant market shares. It is the exclusionary effect of the discrimination that causes anti-competition harm rather than the discrimination per se.Hence,this requires a more case specific effect based analysis to conclude whether a certain act of price discrimination is exclusionary or not. Price discrimination can be the expression of an exclusionary practice but does not in itself cause the exclusionary effect.[4]

A more comprehensive analysis for the cases of price discrimination should rather include the decision passing through the following questions

- Is the entity a dominant firm?
- Is the entity's price discrimination likely to have the effect ofsubstantially lessening competition?
- Does the entity's price discrimination relate to the sale, in equivalent transactions, of goods or services of like grade and quality to different purchasers?
- Does the entity's price discrimination involve discriminating between those purchasers in terms of the price charged for the goods?

Sometimes, price discrimination is just a result of differences in the cost structure different firms of similar product subject to locational differences and other reasons. Hence, there should not be confusion in claiming this kind of price-differentiation as anti-competitive

[3]This is a relevant issue in the area of price discrimination in pharmaceuticals

[4]This is also a point made by David Spector, The Strategic Uses of Price Discrimination, in *The Pros and Cons of Price Discrimination* published by the Swedish Competition Authority, 2005.

Geographic Price Discrimination

- Illustration 2:Geographic price discrimination could lead to efficiency gains in some cases .Suppose a firm "A" charges Rs 8/unit of a particular good at location X and the same good is sold at per unit price of Rs.10 at location Y because of differences in exogenous factors, let's say demand. Arbitrage is not possible because of transaction costs in this case. Now, if price discrimination is banned and a single pricing is to be followed. The monopolist would want to fix the price to Rs.10 and serve only location Y whenever there is more demand in that market than in market X. (If there is more demand in market then the firm will prefer to set the price at Rs. 8 and serve all consumers)[5] The firm might decide to stop supplying to market X to concentrate on market Y where the demand is higher. Hence, here in this case, a ban on price discrimination might lead to welfare losses in practice.

In such cases, granting permission to discriminate results in a Pareto improvement: the strong market's (with higher demand) price is unchanged while the weak market (with lower demand) is served, which increases the surplus of consumers in the weak market as well as the firm's profit[6]

Clauses Referring to Price Discrimination in Other Countries

The following mention of the clause of the cost-induced price discrimination as taken from the Australian Trade Practices Act 1974(prohibited price-discrimination) which continued its actions till the Competition Policy Act Reform,1995

"the discrimination makes only reasonable allowance for differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the differing places to which, methods by which or quantities in which the goods are supplied to the purchasers; "[7]

To bring about an effective decision-making in the cases of abuse of dominance, a more clearly-specified definition of price discrimination is essentially required as provided in the Competition Act of South Africa under section 9(1) as follows:

'An action by a dominant firm, as the seller of goods or services, is prohibited price discrimination, if —
(a) it is likely to have the effect of substantially preventing or lessening competition;
(b) it relates to the sale, in equivalent transactions, of goods or services of like grade and quality to different purchasers; and
(c) it involves discriminating between those purchasers in terms of —
(i) the price charged for the goods or services;

[5]Price Discrimination,MarkArmstrong,Department of Economics,University College London,October 2006.

[6]See Layson (1994) for formal analysis along these lines. According to the literature, a market where the price rises with discrimination is a "strong" market while a market where the price falls is a "weak"market.

[7] Section 49,Austrlian Trade Practices Act,1974

(ii) any discount, allowance, rebate or credit given or allowed in relation to the supply of goods or services;
(iii) the provision of services in respect of the goods or services; or
(iv) payment for services provided in respect of the goods or services."[8]

Conclusion:

To end, it can be said that the competitive implications of price discrimination cannot be generalised and there are no reason to prohibit price discrimination just on the grounds of per se approach as in many cases, a ban on price discrimination can ultimately lead to exertion of dominance by players. Price discrimination acts as a tool and not as a cause for exclusionary effects. Hence, an ex-ante approach can more often than not lead to over-inclusion or under-inclusion of abusive dominance cases. Dynamic efficiency as per the evolving economic markets has to be catered also. The analysis of effects of price discrimination leading to any exclusionary behaviour should be an integral part of an effects-based approach to see if it is an exclusionary pricing or not.

From the section on Abuse of Dominance given in the Raghavan Committee report, it has been found the legislatures mandated the Competition Act to look into several questions which further requires one to judge the effects of the conduct and not just the form of the conduct.

There can be both pro-competitive as well as anti-competitive effects associated with any conduct. Hence to prove the abusiveness of the conduct, one needs to look at the effects it produces and whether those effects leads to exclusionary or any exploitative results.

Putting a ban on price discrimination can lead to dynamic inefficiency and leads to loss in R&D investments. Geographic price discrimination leads to increase in consumer welfare in certain circumstances.Hence,a careful analysis of each conduct should be made rather than just calling the practice as anti-competitive as it would give a very blinded judgment.

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