

# **SYMPOSIUM**

on

## **COMPETITION AND COMPETITIVENESS**

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### **Key Note Address**

*“Competition and Competitiveness:  
Issues and Challenges and Role of Competition Law”*

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## **Key Note Address**

# **COMPETITION AND COMPETITIVENESS**

## **ISSUES AND CHALLENGES AND ROLE OF COMPETITION LAW**

*By*

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Competitiveness involves ability of an enterprise to face competition on a sustainable basis. When it is global competitiveness it has the added condition that the enterprise is able to stand up to competition outside the home market. A global industry is one in which a firm's competitive position in one country is significantly affected by its position in other countries. Competitiveness, to be sustainable will have to be proved in a competitive atmosphere. Competitiveness gained in the domestic market based on market power conferred by statute or through natural monopoly status or through anti-competitive practices does not lead to sustainable results. An enterprise which is competitive in a monopolized domestic market, drawing on its market power thus gained, will not be competitive in an international environment where it would not have the market power which it enjoys in the domestic market. It will not be able to replicate in a foreign market the anti-competitive environment endowing it with the required market power.

The link between competition, productivity, competitiveness and growth are well recognized. It is productivity that immediately follows competition. Total Factor Productivity (TFP) which involves increase in output not accounted for by increase in inputs is the most reliable measure of productivity growth. TFP growth is the result of technical change and improvements in skills and in the ways of organizing production. Development of skills and the resultant competencies are paramount in this regard.

Productivity at firm level determines the productivity at the industry and economy level. Productivity is determined by the level of rivalry among competitors in the market. This brings out the link between competition and productivity. Dominance of the market by one or a few firms tends to vest undue market power in it/ them, which is likely to be abused. The Structuralist approach considered dominance as *per se* bad. This was the guiding principle of anti-trust policy even in the US until 1970. This has given way to the predominance of rule of reason analysis except in respect of hard core cartels. Form based analysis of competition has given way to 'effects' based analysis. Appreciable adverse effect on competition (AAEC) is the touch-stone under Competition Act, 2002. Neither structure nor conduct is considered *per se* anti-competitive. The Indian Act envisages three types of assessment of anti-competitiveness. The predominant methodology is '*rule of reason*' where a number of factors specified in the Competition Act, 2002 in respect of anti-competitive agreements and combinations are looked at by the Competition Commission of India, and the beneficial and adverse effects of these factors on competition in Indian markets are compared. When there is appreciable or significant adverse effect on competition, on balance, the Commission will decide such conduct to be anti-competitive. The second methodology prescribed in the law is "presumption". 'Presumption' under Indian jurisprudence envisages rebuttability. The third methodology is *per se* anti-competitiveness. This is equivalent to non-rebuttability.. Under Competition Act, 2002 horizontal agreements of four types, namely price fixing, market sharing, quantity/supply limiting and bid rigging or collusive bidding are presumed to have appreciable adverse effect on competition in markets. All other types of horizontal agreements and vertical agreements of all types would be judged by the Commission based on *rule of reason* with due regard for factors prescribed in the end. Only specified types of abusive conduct engaged in by dominant enterprises are treated as *per se* anti-competitive under the Act.

Competitiveness of nations is not a static/given phenomenon. A country or an industry or an enterprise which was considered competitive yesterday may be relegated to a lower position today. For example, in 1989 Japan figured as the most competitive

nation in the world as per world competitiveness year back. It appeared that Japan's number one position was unassailable with efficiency and innovation marking its economic growth path. However, Japan finds itself in the position in 2008. The US which is number one position 2008 and had been in the recent years is on the verge of losing this position soon. The World Competitiveness Yearbook has been evaluating and presenting the competitiveness of nations since 1989. While it provides rankings in terms of size, wealth, origin etc., it also provides overall ranking of competitiveness. India ranks 29 in 2008 as compared to 27 previous year, out of the overall rankings for the 55 economies covered in the study.

Competitiveness, productivity, growth are all linked to competition in markets. Competition in markets implies broadly that; there is rivalry among them, there is costless entry and exit and no single firm or any group of firms is able to influence market on its own. Modern competition laws prohibit anti-competitive agreements and abuse of dominant position and regulate combinations (covering mergers, amalgamations and acquisitions). The Indian competition law is modern and nearly state-of-the-art and based on sound economic principles. This has been testified by OECD Economic Survey 2007 of India and also by the WTO Trade Policy Review of India in 2007. Absence of an enforceable competition law results in acquisition of undue market power or dominant position as well as abuse of the same by enterprises in the country. Such acquisition can be through anti-competitive agreements or through certain types of mergers, amalgamation or acquisitions which raise concentration in the market unduly and also results in fore-closure of further competition in the market.

The growth strategy followed by East Asian economies in the seventies and the eighties put in sharp focus the role of industrial policy. East Asian economies, in particular Japan, South Korea, Taiwan, Malaysia and Singapore, pursued an export oriented growth strategy with state support for selected industries. The concept of national champions permeated their strategy. However, the World Bank publication "The East Asian Miracle" (1997) brought out in a sharp way the inherent weaknesses of

state directed growth strategy. The East Asian crisis of 1996-97 vindicated this view point.

Two important premises need to be looked at in this context:

- (i) Competitiveness in the domestic market is essential, in normal course, for being competitive in the global environment;
- (ii) Competitiveness in the domestic market will have to be in a competitive environment (i.e. based on practices consistent with competition rules) to be competitive in the global market. In other words, competitiveness of an enterprise in the domestic market to be sustainable in the international market has to be proved in a competitive environment at home.

There are some important factors that contribute to competitiveness in the domestic market.

First and foremost is market contestability. Contestability implies costless entry and exit in the relevant market in which the enterprise concerned is operating. Entry barriers could be regulatory barriers erected by government (or under its direction), whether it is central, state or local government or statutory authorities. These could also be due to high sunk cost or due to intellectual property rights being held by an incumbent, leading to unassailable technological advantage by it, making new entry unprofitable. Even though entry barriers, especially regulatory barriers (in the form of licensing, quotas etc.) have been removed substantially in India, setting up of units still need a large number of clearances for water, power. Exit is another area of concern. State-of-the-art bankruptcy laws are not in place.

Second comes industry structure. Though structure based competition analysis is passé, industry structure still plays an important role in making the economic environment in which the enterprise is working. A concentrated market structure tends to

generate market power which could result in inefficient utilization of resources and executive slag, as propounded by Leibenstein in the case of monopolist. While structure is not treated as *per se*, there is a high level of correlation between industry concentration and inefficiency in the industry; The OECD Economic Survey of India (2007) noted that:

“Indicators of competition suggest that stable concentration in regional markets has been accompanied by a stable, yet high, degree of market concentration in many Indian industries. For instance, Herfindahl indices have high values based on standard criteria and have not fallen much over time, with an approximately equal number of industries’ concentration ratios rising as falling during the 1990s (Ramasway, 2006). Moreover, in those industries where market concentration has risen, one or two large firms typically dominate the market (a number of which are public sector undertakings). Similarly, average price-cost margins increased in the 1990s across virtually all two-digit manufacturing sectors (Balakrishanan and Suresh-Babu, 2003).” [OECD (2007) Economic Survey, India]

The OECD survey also found that:

“tariff reduction helps raise productivity but impact varied across industries. It was noticed that the extent to which the output of industries if concentrated in a few firms is indeed remarkably high as compared to other major economies. Applying a standard definition of concentration (a Herfindahl index of over 1800) to industry census data shows India’s share of highly concentrated industries to be more than three times higher than that of the United States or China, and twice as high as that for Germany (Table 2.3, first panel). It is possible that this high degree of concentration is due to the small size of the Indian market relative to optimal plant sizes. Nonetheless, the existence of market concentration and dominant firms suggests that the possibility of anti-competitiveness behaviour exists in many manufacturing industries.”

Third comes competence. Competence is at the core of competitiveness. An enterprise, to be competitive, should have the competence in its field of activity. Competence is the ability to act in an efficient way. Here efficiency breaks down into; efficiency in the allocation of resources (allocative efficiency) and efficiency in the utilization of resources (productive efficiency). The concepts of static efficiency and dynamic efficiency are also very relevant. The reference point for competitiveness in the domestic market is the frontiers of technology and organizational skills domestically available. At the global level it is the frontier technologies and skills available globally.

Fourth we have technology transfer. Related to competence is technology transfer. Limits on technology transfer by way of cap on payment for technology or on the period of technology transfer (subject, of course, to multilaterally agreed principles, as may be available) and obstructive screening mechanisms can block smooth flow of technology and starve the domestic industry of state-of-the-art technologies available internationally.

Fifth, comes the role of Research & Development (R&D): Related to competence again is the need for promoting R&D. Investment in R&D is an indicator of the efficiency of the industry /enterprise, other things remaining the same. Joint research and development could be an option, provided this does not border on anti-competitive practice. Under Competition Act, 2002 while presumption of anti-competitiveness is envisaged in respect of four types of agreements amongst competitors, there is an exemption to such presumption in case of efficiency enhancing joint ventures. For example, research and development undertaken jointly by competitors might be necessary in certain circumstances when, for example, the cost of R&D may be very high and the results, very uncertain.

However, it is also likely that collaboration in R&D may be used to eliminate potential competitors in the innovation market. When two competitors are, at the same time, engaged in R&D for the development of a specific medical solution for a disease,

there is a likelihood that when they are on the verge of developing a new medicine, they do not want any more to compete. They may be tempted to agree to get merged or to have a collaborative arrangement so that only one supply source is there for the newly developed medicine. In such cases, the cause of innovation is not served. On the other hand, it is monopolization or acquisition of monopoly power that results.

Sixth, there is the need for Intellectual property rights (IPR) protection. IPR protection promotes and incentivizes innovation. As long as IPRs are exploited reasonably they enhance innovation and promote competitiveness. When such rights are used in unreasonable ways they may block further innovation and may breed inefficiency, adversely affecting competitiveness of the industry concerned, in the medium to long term. Competition Act, 2002, under section 3 (5) (i) envisage that nothing contained in the section prohibiting anti-competitive agreements shall restrict the “right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under” laws related to copyright, patents, trade marks designs, semi-conductor integrated circuits layout-design and Geographical indications. It is important to note that in case IPRs are exercised by competition authorities in an abusive manner such conduct would be treated as anti-competitive *per se* provided the Commission is satisfied that the IPRs in question confer dominant position in the relevant market to the enterprise concerned. This is unlike certain other jurisdictions where exercise of IP rights by right holders is judged based on ‘rule of treatment’. (US and EU, for example).

Training Complements Technology transfer on R&D efforts as well as technology transfer would be helpful only to an extent. What is important is to have dissemination of the technology and skills acquired through technology transfer and R&D, to the employees, in general. Lab-to-land’ or ‘Lab-to-factory’, as some say. Productivity enhancement would depend considerably on the extent to which the employees and technicians are trained in the use of machines and instruments that embody technology. Competency is developed only when appropriate training is imparted to employees/workers.



Competitive access to infrastructure is crucial. Infrastructure can make a huge difference to the competitiveness of enterprises. In case infrastructural bottlenecks are faced by all the enterprises in a relevant market in an equal way competitiveness in that relevant market may not be affected in a closed economy environment. However, at the global level or in an open economy environment the domestic industry will be faced with enterprises from other countries which enjoy superior infrastructure support. Infrastructure in many developed countries are the result of a long period of heavy investment. Therefore, the cost of such infrastructure to the enterprises at present in those markets are not that high. On the other hand, developing countries like India are in the process of developing their essential infrastructure like ports, roads, airports, railways etc. In most cases such infrastructure is developed on 'concession' basis through 'public - private partnership' (PPP) where use of the facilities is charged. The cost of such infrastructure to the Indian enterprises will, therefore, be comparatively high, thereby, adversely affecting competitiveness at the global level.

Competition issues related to infrastructure sector are particularly relevant for developing countries like India because many of the critical infrastructure sectors were public monopolies, and the process of opening up of these sectors through PPP to the private sector has started only in the last few years in India. In the absence of application of competition principles, such privatization would not only result in public monopolies being replaced by private monopolies. Therefore, there is the whole issue of designing concession, allocation of concessions and monitoring the implementation of concessions. Since in infrastructure sectors "competition in the market" is generally not possible or practicable, under concessions what is envisaged is competition for the market. *Ex ante* conditionalities envisaging certain restrictions on competition is possible under concession agreements. However, it is also important to ensure that to the extent possible competition principles are built into such agreements so as to ensure that the dominant position conferred through a concession contract is not abused by the concessionaire.

Conditions of scarcity are not conducive to competition and competitiveness. Even when infrastructure availability is adequate it may not be accessible to all players in the relevant market in a non discriminatory way. This could be due to vertical integration with one or a group of enterprises monopolizing the input (infrastructure). This could also be due to inadequate rules in place. For example, unless there is transparent and clear provisions in the concession agreement regarding non-discriminatory access to infrastructure to all users, there can be discrimination in providing access. A vertically integrated enterprise may deny access to its competitors, unless there is an effective competition authority with sufficient powers of penalty and deterrence in place.

### **Interface between macro policies and micro policies for competitiveness**

Competitiveness is determined in a macro-economic environment. Stable macro-economic environment is essential for growth. External stability in terms of stable exchange rate and internal stability in terms of low inflation are essential for enterprises to efficiently operate in the market. Policy surprises should be avoided. Transparency in policy making based on wide consultation with stake holders would avoid policy surprises. Such a stable economic environment would enable enterprises, that are otherwise efficient, to evolve into competitive enterprises.

Investment in physical and human capital provides the necessary support for efficient engagement in production. Infrastructure development involves both hard (physical) infrastructure and soft infrastructure. Physical infrastructure covers, rails, airports, sea ports etc. Soft infrastructure consists of telecommunications, energy, health care, education etc. The role of primary health and primary education on development was excellently brought out by the World Bank study on the East Asian Miracle (1997).

A stable interest rate, exchange rate and inflation regime enable enterprises to plan their projects and programmes in an atmosphere of certainty. It is to be noted that while enterprises can reduce risks in many areas through efficient management, the

macro economic risks are beyond their control and they have to rely on government policies.

Macro policies need to be supplemented by micro environment to increase competitiveness and productivity. Such policies include: appropriate skills at the firm level, supporting industries, corporate governance of adequate level and strong competitive pressure in the market, with the implementation of a comprehensive competition law.

### **Reforms in India**

The period of leveraging growth through subsidies and subservience of competition policy to industrial policy is over. Local content and trade balancing requirements come under the scanner of multilateral agencies like the WTO. Idea of deliberately creating national champions is not in currency any more. The age of financial repression and directed credit is also over. Re-engineering and process patenting is also no more available. Competition has to be based on core strength, which is dependent on competencies created through technology transfer, R&D, education and training.

Deregulation in the Indian economy started in the mid eighties. This triggered a much higher growth rate as compared to the present rate of growth until then. However, it was not before the comprehensive economic reform of 1991 that such reform became sustainable. The economic reforms programme initiated in 1991 covered industrial, investment, trade, monetary, fiscal, exchange rate, etc. policies. However, a gap in the reform package was being felt, related to competition law. This prompted the setting up of a High Level (Raghavan) Committee which recommended a new competition law in place of the MRTP Act, which was originally designed to address the needs of the control regime that existed before 1991.

As Dr. Virmani (2005) has argued, the market reforms that appear to have had strongest dynamic effects in India are those relating to production, investment and

external controls which are best understood through the presence of competition. The system of controls over the production and investment as also price and distribution had a restraining effect on enterprises to compete.

OECD Economic Survey of India 2007 noted that there has been wide divergence in economic performance in different states in India, with firms in those states and sectors with the best institutions gaining, and those in the more tightly regulated states and sectors falling further behind. The report also notices that

“while individual firms and industries benefited from reforms, productivity enhancing resource allocation nevertheless remains low. Topalova (2003, 2004) found a strong positive impact of trade liberalization on total factor productivity (TFP) using a firm level panel data starting from 1989 to 2001. She found that a 10 per cent decreasing tariffs led to a 0.75 per cent increase in total factor productivity. However, because of the very low exit rates the gains accrue within existing firms because of the non-exit of unproductive firms. In fact, with the liberalization of entry barriers and the consequent increase in net firm entry rates had strong positive impact on productivity. Absence of enforceable bankruptcy code has had, on the other hand, a chilling effect on productivity growth in the country.”

A conducive regulatory framework is essential for enterprises in sectors which are prone to market failure, to function in an efficient way. Regulation is not always a necessity. Competition should be allowed to play out in the markets as long as there are no compelling reasons for regulating the conduct of market players. Such a regulation, when necessary, should serve a public objective which is generally obvious. Even when regulation is put in place to take care of market failures, this has to be time limited, as far as feasible. One of the major mandates of any regulator is to take the regulated sector closer to competition. Once that objective is achieved, the regulator will have to “wither away”. Certain countries have already built into regulators’ mandate a sunset clause

indicating the time period within which the regulator will have to take the sector to 'competition' and exit (Netherlands, for example).

While India has gone a long way on the patch of reform there are a few areas where reforms have not been to the desired extent. These areas include infrastructure, transaction cost, manufacturing sector which continues to contribute only less than 17 per cent of the GDP, inadequate cluster development, over regulation in the financial sector, substantial difference in reforms at the level of states, inadequate bankruptcy laws and inadequate regulatory reform.

In the context of any discussion on competition and competitiveness one cannot avoid stressing the need for expediting these reforms. Simultaneously, the competition law in the country has to be enforced so as to enhance competitiveness of the Indian industry at the international level.

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