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Effectiveness of Competition Protection Policy in Global Business

Abstract

In contemporary business conditions, large and financially powerful economic systems seek to limit or entirely eliminate other market participants in order to maximize profits for themselves. On the other hand, this goes against the interests of other market participants: a large number of smaller companies, consumers, and the state, which through their institutions and penalty policies seek to establish equal and fair market conditions for all market participants. Only under conditions of fair competitive struggle do new entrepreneurial ideas and innovations develop, leading to progress and social development. Since 2005, the Republic of Serbia has accepted modern EU regulations by adopting laws in the field of competition policy, creating conditions for fair market competition in our area.

Keywords: *competition policy, economic efficiency, market, economic entity.*

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1. Introduction

In contemporary global economic environments, competition policy holds a significant position in achieving economic and political objectives such as: increasing the economic efficiency of enterprises, promoting research and development within them, efficiently allocating resources, maintaining equal conditions for all market participants, strengthening the competitiveness of domestic enterprises in the international market, which consequently reflects on the standard of living of all citizens. It is essential for this policy to be supported by appropriate institutions and legal regulations, as well as the economic policies of the creators of a country's economic development. Economies of underdeveloped and developing countries are particularly vulnerable to competition distortion, considering the level of institutional development within them as well as the limited possibilities for the full implementation of legal regulations in this area.

Competition policy and law in the Republic of Serbia are fully linked to competition policy and law in the EU, and the process of building a modern legislative framework in the field of competition protection began only in 2005 with the adoption of the first law in this area. The three pillars common to all modern competition protection systems relate to: restrictive agreements, abuse of dominant position, and concentration control. European countries also have a fourth pillar, known as state aid control. The first two pillars concern competition violations when they occur, so their nature is ex post. On the other hand, competition control and state aid control are carried out before the violation occurs, with the aim of preventing it.

2. Development of Modern Competition Policy

The roots of modern competition policy were formed in the nineteenth century in the territory of the United States as a response to the growing fear of companies forming trusts with the aim of consolidating market power. Trusts exhibited all the characteristics of monopolistic consolidation as they eliminated any competition among their members, who voluntarily placed themselves under the control of the trust's joint administration. Trust members were formally independent market participants, although by joining the trust, they accepted a relationship of mutual trust and firm interconnectedness that excluded competition.

The elimination of competition within trusts was aimed at monopolizing the markets they operated in, thereby creating or strengthening a dominant position in the market. With the aim of limiting the operations of trusts, the Sherman Antitrust Act was enacted in 1890, which is considered the first modern law in this area and the beginning of the modern era of competition policy. The formation of trusts was preceded by significant advances in transportation and communication (railway transport, telegraph, and telephone services), which significantly improved the connectivity of market participants and created large and unified markets for many economic sectors.

The expansion of market scopes imposed on companies the need to take advantage of economies of scale, which encouraged the growth of firms motivated to efficiently utilize their capacities. In order to achieve full capacity utilization, companies often engaged in destructive price wars, a trend that forced them to join cartels and trusts. The goal of such associations was to maintain high prices and high profit margins. The result of companies joining trusts and cartels led to the detriment of consumers of final products, whose welfare was reduced due to paying higher prices. Additionally, it endangered small producers who paid a high price for inputs originating from sectors where cartels and trusts were present (Ristić, Trifunović, 2022.).

Sections 1 and 2 of the Sherman Antitrust Act expressly prohibit 1) agreements among market participants that distort competition and 2) unilateral conduct by market participants that monopolizes or attempts to monopolize the market. The Sherman Act imposed a ban on price-fixing agreements among market participants, a principle that is still upheld today. This particularly applies to horizontal agreements, such as cartels. Additionally, this law explicitly does not penalize the possession of a monopolistic position but rather its abuse, which manifests in restricting trade and business of other market participants.

Competition, by its nature, is a dynamic process, a procedure aimed at achieving what others are simultaneously striving for (Hayek, 2016.). Although competitive pressure is the fundamental product of competition, it is not the sole aim of competition but rather an instrument for achieving economic efficiencies, which are a prerequisite for maximizing overall welfare in that market. Thus, a chain is established that competition initiates: competitive pressure - economic efficiency - maximization of welfare (Ristić, Trifunović, 2022.).

Types of economic efficiencies relevant to competition protection are: a) allocative, b) productive, c) dynamic, and d) selection efficiency (Begović, et al. 2019.). Allocative efficiency in a market is achieved with the optimal use of societal resources, at a price equal to marginal costs, where supply equals demand, thereby maximizing overall welfare as the sum of consumer and producer surplus. Products are produced without excess supply or demand in the market, thus achieving efficient resource allocation.

Productive efficiency is achieved when products are produced at minimum average (unit) costs given a certain technology. Market productive efficiency depends on the productive efficiency of each individual participant in the market. Productive efficiency can be achieved through economies of scale, economies of scope, and realizing external growth synergy. Economies of scale are achieved by firms striving to optimally utilize their production capacities, reaching the minimum efficient scale of production where average costs are minimized.

Dynamic efficiency refers to long-term cost savings resulting from improving the quality of existing products or offering entirely new products that consumers were not previously aware of, arising from an innovative process within the company. Competitive pressure stimulates entrepreneurial efforts of companies to continuously innovate to enhance their position in the market. The entrepreneurial process is driven by the entrepreneur, and the result of successful innovation is positive economic profit - where total revenues exceed all opportunity costs (Stojanović, 2021.).

Competition leads to selection efficiencies. It forces inefficient firms to exit the industry they operate in and release inefficiently used resources for alternative and more efficient uses. Surviving market participants are those that are productively efficient, innovate, or successfully imitate others' innovations. The exit of inefficient firms from the industry opens up space for the entry of new and more efficient firms into the market. From this, it follows that selection efficiency is linked to productive and dynamic efficiency - less productively efficient and less innovation-prone firms exit, while more efficient and innovation-prone firms enter the market.

In the EU, the competition protection system is organized at two clearly defined levels: national and supranational. For example, a cartel whose impact does not exceed the borders of the national markets of an EU member state falls within its jurisdiction, and if the spill-over of that impact on the markets of other countries becomes significant, the jurisdiction becomes supranational. The beginning of supranational history of competition protection is associated with the first treaties signed by European countries after World War II. The purpose of these treaties, among other things, was the intention to create a single market within the European territory.

The emergence and development of any form of competition protection cannot be viewed independently of the social, economic, and political environment in which it originated. The three common pillars for all modern competition protection systems relate to: restrictive agreements, abuse of dominant position, and concentration control. European countries also have a fourth pillar, known as state aid control. The first two pillars concern competition violations when they occur, so their nature is ex post. On the other hand, competition control and state aid control are conducted before the violation occurs, with the aim of preventing it.

In 2005, the Republic of Serbia adopted the Competition Protection Act (Official Gazette of RS, No. 79/2005), which envisaged the establishment of the first modern body for overseeing this legislation, the Commission for Protection of Competition, which began operating in 2006. State aid control is regulated by a separate law, the Law on State Aid Control (Official Gazette of RS, No. 51/2009.). The Commission for Protection of Competition, among other responsibilities, decides on competition violations and permitted concentrations, imposes administrative measures to remedy these violations, participates in the drafting of regulations in the field of competition protection, issues instructions and guidelines for the implementation of legal and sublegal regulations, and provides opinions on the application of these regulations, among other duties.

The Competition Protection Act of the Republic of Serbia, in Article 1, states that competition protection is carried out: "...in order to achieve economic progress and societal welfare, particularly benefiting consumers." According to this Law, market power "of market participants is determined in relation to relevant economic and other indicators, especially: 1) the structure of the relevant market; 2) market share of market participants whose dominant position is established, especially if it exceeds 40%; 3) actual and potential competitors; 4) economic and financial strength; 5) degree of vertical integration; 6) advantages in supply and distribution access; 7) legal or factual barriers to market entry by other participants; 8) buyer power; 9) technological advantages, intellectual property rights."

The most significant indicators of market power (Bishop, Walker, 2002) include:

- Price elasticity of demand;
- Market structure indicators;
- Entry barriers and potential competition;

- Growth barriers (expansion);
- Product differentiation;
- Buyer market power;
- Nature of oligopolistic interaction.

3. Key Areas of Competition Policy in the Contemporary Market

Cartels represent one of the most severe forms of competition violation. Instead of competing with each other, market participants agree to eliminate mutual competition, inevitably leading to price increases and a reduction in consumer surplus. Therefore, it is important to distinguish between a monopoly and a cartel. The path to a monopoly is often paved with innovations and may employ new innovations to prevent potential competition from entering (Harrington, 2008).
Cartels are horizontal agreements "resulting from agreements - explicit or tacit agreements through which they agree, generally speaking, to stop controlling each other, to stop competing with each other, and to agree on all essential parameters of their operations" (Begović, et al., 2019). When it comes to essential parameters of operations, this primarily refers to price or offered quantity, but also includes geographic market division, customers and sources of supply, as well as circumventing public competition in auction markets (which often boils down to price-fixing agreements).

There are numerous market factors that influence the stability of cartels. The emergence and survival of cartels are favored by market concentration, which typically coincides with a small number of true rivals. High entry barriers prevent potential competition from entering the relevant market. The market growth rate increases the stability of cartels, which is also influenced by the degree of product homogeneity or differentiation (Pepall et al., 2014). Generally, a cartel will be more stable in the case of product homogeneity than in the case of product differentiation because it is easier to agree on prices and easier to monitor deviations from prices.

The application of the most-favored customer clause, competition clause, and greater market transparency regarding price information availability increase the stability of cartels (Motta, 2004). Additionally, the exchange of information on prices and quantities of individual products solidifies the stability of cartels, both with information from the previous period and planned sizes.

Competent competition authorities can reduce the stability of cartels by increasing the likelihood of initiating an investigation, especially if the investigation is successful. Additionally, these authorities have the power to determine the amount of fines for each cartel agreement they uncover. It is expected that stricter punishment reduces the stability of cartels, but for a cartel to be penalized, it must be detected, which requires high-quality evidence.

Modern competition protection policy is based on leniency programs, which allow a cartel member who voluntarily reports to the competent authority to receive a reduction in penalties (provided they are not the cartel leader). This mechanism is particularly effective if it allows reporting even after the initiation of an investigation, especially in situations where the competent authority does not have sufficiently strong evidence of the cartel.

Vertical agreements can be either price-related or non-price-related. In vertical price-related agreements, the manufacturer or distributor sets a fixed, minimum, maximum, or recommended price for the resale of their product. These agreements are beneficial for consumers when they eliminate double markups and encourage non-price aspects of competition. The most common forms of non-price-related vertical agreements include agreements on territorial exclusivity, exclusive distribution, after-sales services, and franchises.

Possessing a dominant position, and even a monopoly itself, is not prohibited by competition law, but practices leading to the abuse of such positions are prohibited. Two different groups of such practices are identified in European jurisdictions - the first are aimed at exploiting consumers, and the second at squeezing competitors out of the market. Consumer exploitation typically occurs through the imposition of excessive prices, while predatory behavior, tying arrangements, price discrimination, and price scissors are some of the most significant practices for squeezing competitors.

The ultimate consequence of squeezing competitors, both existing and potential, is the exploitation of consumers.

Mergers, acquisitions, or takeovers, whether horizontal, vertical, or conglomerate in competition law, represent concentrations from which numerous positive effects can be expected. Primarily, these are economic efficiencies that can arise from better utilization of economies of scale and scope, important synergistic effects, all of which can be a stimulus for innovative activity and dynamic efficiencies. However, the negative effects of concentrations on competitive conditions are the reason for implementing a concentration control policy. Concentrations can lead to unilateral and coordinated actions that can significantly restrict, distort, or prevent effective competition in the markets where they take place (Ristić, Trifunović, 2022).

Concentration control is by its nature ex ante - predicting the competitive conditions that will arise if the concentration is approved. It is a test that serves to indicate whether the concentration meets the conditions for permissibility. Different jurisdictions apply different legal standards, but three tests are crucial: the dominance test, the significant harm to competition test, and the significant limitation, distortion, or prevention of effective competition test.

The competition policy in the Republic of Serbia should be based on the following elements (Djekić, 2009):

- Incorporating EU standards into the national legal system for competition protection.
- Further enhancing competition protection in cases of violations such as prohibited agreements, abuse of dominant position, concentrations, as well as improving the functioning and independence of the Competition Commission.
- Establishing an independent and functional body for monitoring state aid, as well as establishing an adequate legal framework for controlling state aid.
- Developing awareness and informing market participants about the importance of competition protection – deepening the knowledge of all involved in the process, particularly creating a pro-competitive public opinion.
- Increasing consumer welfare, which increases with the level of competitiveness in a particular industry. This primarily involves working to increase the competitiveness of economic entities and the national economy as a whole, through the protection of functional competition.
- Enhancing consumer protection in the following areas: product and service safety and quality, as well as achieving lower levels of their prices through market mechanisms.
- Protecting small and medium-sized enterprises, which does not mean protecting incompetent economic entities, but rather increasing their number is desirable from the standpoint of competition protection policy.

4. Conclusion

An effective competition policy is extremely important for developing countries like the Republic of Serbia. It can contribute to creating an adequate economic environment for the development of small and medium-sized innovative enterprises, which are the backbone of growth, employment, and increasing international competitiveness. The creation of monopolies and dominant positions of companies, cartel agreements, concentrations, and other forms of competition infringement will certainly have negative effects on the domestic economy in the long run. Therefore, adequate support for competition protection bodies is needed, both from state institutions and from the professional community, civil society organizations, increased coverage of this topic in the media, and in higher education programs.

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