

# Competition law and monopsony economics essay



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Can a buyer be the biggest bully? The classical theory of monopsony answers this question. It envisions a market scenario with only one buyer, who can use his leverage to reduce the quantity of product purchased, thereby driving down the price that he has to pay. Seldom does a monopsonistic situation arise in the market, so much so that little has been thought till date about the potential adverse impact of such a scenario on market competition. Another reason for the antitrust analyst's apparent neglect of the power on the buyer's side of the market may be that such power tends to reduce the selling price of a commodity, thereby causing a prima facie increase in consumer welfare[1], which has always been one of the traditional goals of competition law.

The said lack of emphasis, unfortunately, remains blind to the symmetry of markets: for every seller there is a buyer. Therefore, just like sellers, buyers too may have market power. In course of this research project, the researcher intends to drive home the point that price fixing and other forms of collusion are just as unlawful when the victims are sellers rather than buyers. Also referred to as the " flip-side version of monopoly"[2], monopsony can thus have valid antitrust concerns.

The primary aim of this project is to analyze the theory of monopsony from an antitrust law approach. In the first chapter initial part of the project, the researcher has provided a brief description of the standard monopsony theory and the economic implications thereof. In the next chapter, the concerns of monopsony under antitrust law will be addressed with significant emphasis on the concept of abuse of dominant position. Finally, the researcher will give examples of judicial interpretation of monopsonies. All

other forms of legislative remedies dealing with monopsony fall outside the scope of this paper.

## **B. Classical Monopsony -What does It Entail?**

Pure monopsony can be looked upon as the demand-side analogue of the monopolist who is a single seller. It thus follows that just as the monopolist has market power in selling its products; the monopsonist has buying power in purchasing its necessities too.[3]The economic grievance towards both is therefore similar too -both cause social welfare losses.

From a slightly different perspective, the social welfare effects of monopsony are analogous to those of monopoly -too few resources will be employed in the production.[4]At the point where supply intersects with demand, the value of the good, as measured by the demand price, equals the cost to society of providing that quantity as measured by the supply price. At this point, the employment level is optimal in a social sense because all of the gains from trade have been realized, and total welfare is maximized.

However, the monopsonist will not hire this number of units because it is not privately optimal to do so; it will employ a smaller quantity. As a result, too few resources will be employed, as has been stated above and the monopsonist will finally forgo potential gains from trade opportunities.

[5]Since the monopsonist forces a lower price upon suppliers, one may infer that its costs for conversion of the intermediate good into a final one will fall as a result and consumers (of that final good) will benefit through lower prices on the monopsonist's output.

However, the researcher would like to differ from such inference and point out that the monopsonist does not pass on said lower costs simply because the relevant costs for pricing decisions are marginal costs.[6]What the researcher intends to portray is that monopsony power is to the demand side of a market what monopoly power is to the supply side. Monopoly power is indicated by the ability of sellers to raise price above competitive levels, which requires the ability to limit output. Monopsony power, on the other hand, involves the ability of buyers to lower input prices below competitive levels, which requires the ability to restrict the quantity demanded of the input.[7]In either case, the quantity that would be exchanged is less than the quantity exchanged under competitive conditions, and the result bespeaks allocative inefficiency.[8]Furthermore, the fact that the reduced input prices enjoyed by the monopsonist do not lead to reduced output prices, is, frankly, ironical. On the contrary, when the monopsonist has market power in its output market, the reduced input prices cause higher output prices.

### **C. Monopsonist Concerns- Abuse of dominant position**

The Indian Competition Act, 2002[9]aims at preventing practices which have adverse effect on competition, to protect the interest of consumers and to ensure freedom of trade carried on by other participants, in markets, in India.[10]It is important to note here that the Indian Competition Act, like most other legislations introduces the concept of “ abuse of dominant position”. This means that it prohibits only abuse of power not the mere use of it.[11]

There are primarily three stages in determining whether an enterprise has abused its dominant position. The first stage is defining the relevant market.

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The second is determining whether the concerned undertaking is in a dominant position in that relevant market. The third stage is the determination of whether the undertaking in a dominant position has engaged in conducts specifically prohibited by the statute or amounting to abuse of dominant position or attempt to monopolize under the applicable law.[12]

The competition laws of the European Union, United Kingdom, Germany and India contain a general prohibition on the abuse of dominance by undertakings/enterprises. Article 82[13]of the Treaty of the EC, Section 18(1)[14]of the Competition Act, 1988, U. K., Section 4(1)[15]of the Indian Competition Act, 2002, Section 19(1)[16]of the German ‘ Act Against Restraints on Competition’ and Section 2[17]of the Sherman Act contain provisions on abuse of dominant position.

## **1. Defining Relevant Market**

The first step in determining whether an undertaking or firm has abused its dominant position is defining the relevant market which has two broad dimensions namely, the relevant product market and the relevant geographical market.[18]

The Indian Competition Act, 2002, defines a “ relevant product market” and “ relevant geographic market”. Section 2 (t) defines the relevant product market as a market comprising all those products or services which are regarded as interchangeable or substitutable by the customer, by reason of the characteristics of the product or service, the prices and the intended use. Section 2 (s) defines the relevant geographic market as a market comprising

the area in which the conditions of competition for supply of goods or provision of services are sufficiently homogeneous and can be distinguished from the conditions prevailing in neighbourhood areas.

There is however, no such case either in India or in other countries, where such a definition has been challenged on the grounds that it takes into account supplier side abuse as only the views of the customer's attitude towards substitutability of the goods is taken. Keeping this question aside and assuming that this problem is resolved by judicial interpretation, the other elements of abuse of dominance also need to be assessed.

## **2. Definition of a ' Dominant Position'**

While the laws of numerous countries prohibit or declare illegal the abuse of dominant position or monopoly or attempt to monopolize of certain conduct by undertakings in a dominant position, the manner in which ' dominant position', ' monopoly' or ' substantial degree of market power' is defined is different in different countries.

The concept of dominance is broader than economic power over price. It is not the same as economic monopoly, although a monopoly would clearly be dominant.[19] This is a clear indication of the fact that dominance is recognised as cases even apart from monopoly and thus the possibility of characterising monopsony as down-stream dominance strengthens here.

Explanation (a) to Section 4 of the Indian Act defines dominant position as " dominant position means a position of strength, enjoyed by an enterprise, in the relevant market in India, which enables it to-

(i) operate independently of competitive forces prevailing in the relevant market or

(ii) affect its competitors or consumers or the relevant market in its favour.

Unlike the Monopolies and Restrictive Trade Practices Act[20] where a dominant undertaking had to satisfy a quantitative requirement of control over at least 1/4th of the total “ goods” or “ services” produced or rendered in India, dominant position under the Indian Act[21] is “ a position of strength enjoyed by an enterprise in the relevant market, in India which enables it to operate independently of competitive forces; or affects its competitors or consumers or the relevant market in its favour.[22]

A number of factors are taken into account to determine whether a particular undertaking or group of undertakings is in a dominant position in the relevant market. The factors to be taken into account are inter alia market share of the undertaking or enterprise, barriers to entry, size of competitors and financial power of the enterprise.[23]

However, the market share that a particular undertaking has in the relevant market is one of the most important factors to be taken into account to determine whether it is in a dominant position and under the laws of some jurisdictions, the existence of a market share of or above a specified level gives rise to a presumption of existence of a dominant position (although rebuttable).[24]

In Hoffmann-La Roche & Co. AG v Commission of the European Communities[25], it was observed that the existence of very large market

shares though a very important factor, is not constant and its importance varies from market to market according to the structure of these markets. The Court observed, “ Furthermore although the importance of the market shares may vary from one market to another, the view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position”. [26]

Competition authorities can utilise measures like buyer concentration and elasticity of supply, as well as performance measures such as profitability and relative bargaining power compared to the sellers, in order to assist them in the assessment of buyer power. The structure of the buyer and the seller markets must also be taken into account. [27] The number of firms is also essential in judging whether buyer concentration can provide a representative measure of buyer power. A small number of firms that account for a high share of purchases indicate that the buyer market is concentrated. [28]

### **3. Abuse of Dominant Position**

The Indian Act does not prohibit dominance or the presence of market power per se, and sheer market power alone, or even market dominance, does not constitute abuse of dominance. Abuse of dominance occurs when a dominant firm, or group of firms, substantially prevents or lessens competition, by engaging in acts that aim to eliminate or discipline competitors, or simply to stop potential competitors from entering the market in question.



The treaty of the EC does not contain an express definition of abuse of dominance but merely lists certain conducts which, if engaged in by a dominant undertaking will amount to abuse of dominance. In Hoffmann-La Roche it was observed that, “ The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where , as a result of the very presence of the undertaking in question , the degree of competition is weakened and which , through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators , has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition”.[29]

In *Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities*[30]it was observed that, “ Abuse may therefore occur if an undertaking in a dominant position strengthens such position in such a way that the degree of dominance reached substantially fetters competition, i. e. that, only those undertakings remain in the market whose behaviour depends on the dominant one”.

In the light of the fact that the existing antitrust legislation prohibits only abuses of power, the question assumes significance as to whether in cases of either monopoly or monopsony, it would entail an abuse of market power to use that power merely to influence price. Rationality suggests that the legislative prohibition should extend only to price-only effects. However, later cases will reveal how only price-effects are not enough and that a closer look must be taken to strike down abusive case of monopsony by the judiciary.

## **D. Judicial Trends under Monopsony- A Concern for society?**

Recent surveys conducted in U. K.[31] have revealed that the current judicial trend is towards substantive analysis, instead of the “ bright line” tests[32] that were in vogue before. As a result, judges are required to appreciate in entirety economic consequences of an action, lest they commit mistakes. For example, if judiciary uses initial impact on price as the test for prohibited conduct, monopsonistic behaviour may be excused, even when it ought not to be. Such a conclusion, although erroneous, may be reached at in the following cases: first, strictly from substantive perspective, judiciary may perceive lower prices as an indicator of the harmlessness of a practice. Moreover, procedurally speaking, injury suffered by sellers who have been compelled to sell their outputs at lower prices may not qualify as antitrust injury in the traditional sense.

The researcher would in this context draw attention towards a recent controversy surrounding the matter of Balmoral Cinema v. Allied Artists Pictures,[33] which highlights the significance of proper economic analysis of monopsony scenario. In this case, the exhibitors (buyers) colluded to refrain from competitive bidding for films offered by distributors. While such an action might have fallen foul of standard bright-line antitrust analysis as a per se unlawful horizontal agreement to fix price, the judiciary held instead that the practice of the colluding buyers was simply causing lowering of prices paid by exhibitors to distributors, which might lower prices to movie-goers at the box office, thereby facilitating rather than undermining consumer welfare. Without delving into propriety of the judgement, the

researcher would like to posit that it had come perilously close to equating lower prices with overall economic benefit. It is for this very reason that in the case of monopsony, the presence of lower prices should not end the analysis because there is no correlation between an initial decrease in prices and any overall long-run benefits to consumers.

## **E. Conclusion**

The aforementioned analysis clearly indicates that there is a buyer for every seller and anticompetitive conduct by buyers can cause adverse economic consequences similar to those caused by sellers' anticompetitive behaviour. However, the competition policymakers are yet to fully incorporate the symmetry of markets into their analyses, instead restricting their focus solely on seller-behaviour. Especially in a country like India, monopolistic tendencies are in essence sought to be curbed. It is highly doubtful if the courts would really read monopsony into the statute and declare it bad in law as well. The Indian judiciary must strengthen the economic foundations for dealing with anticompetitive conduct by buyers too. The requirement assumes all the more significance owing to the simple statement of fact that concentration of power on the buying side of a market almost inevitably causes a decrease in price, which may tempt a judge in turn to erroneously stop substantive analysis at that stage, or declare that the plaintiffs have not suffered antitrust injury.[34]

In course of this project, the researcher has sought to emphasize a few matters. First, lower input prices resulting from the exercise of monopsony power do not ultimately translate into lower prices to the monopsonist's customers and increased overall consumer welfare. Thus, neither the

substantive nor the procedural analysis should stop with the initial impact on input price. Second, the monopsony model typically employed in many economic texts and antitrust casebooks seriously understates the variety of consequences of the exertion of monopsony power. Finally, the long-run consequences of monopsony must not be ignored. Lower input prices in the short run may mean decreases in both future supply and in ultimate, overall consumer well-being.

This conclusion has implications on the debate about whether the antitrust laws should be applied using “consumer welfare” or “total welfare” standard. Those espousing the “consumer welfare” standard believe that antitrust analysis should focus on the interests of consumers who purchase a final end product or output in the chain of distribution. In contrast, proponents of the “total welfare” standard argue that the antitrust laws should seek to maximize society’s wealth as a whole rather than focusing on any one type of market participant.

The fact that many courts and enforcers outside India have not been reluctant to condemn anticompetitive buy-side conduct, which potentially poses little or no direct threat to consumer welfare, suggests a willingness on their part to take into account the interests of all market participants. Perhaps this indicates some recognition by courts and enforcers that in the long run, monopsony can ultimately be just as harmful to consumers as anticompetitive conduct occurring in the output market. While the judicial decisions may not completely resolve the debate about the consumer welfare and total welfare standards, perhaps it helps to solidify to some degree what courts and enforcers have been suggesting all along—that

conduct on the buy side of the market should be treated just as strictly as conduct on the sell side of the market.

Thus, the researcher hopes that the Indian law and judiciary will develop, in light of these rulings abroad to set aside the traditional perception of sellers being largely immune to antitrust violations.

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