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ANALYSIS OF THE LAW ON COMPETITION PROTECTION

Anti-Corruption Council of the Government of the Republic of Serbia
ANALYSIS OF THE LAW ON PROTECTION OF COMPETITION

In July this year the new Law on Protection of Competition was adopted (Official Herald of the Republic of Serbia No. 51/09), which has been applied since 1st November 2009. It superseded the law with the same title, which was adopted in 2005. The Anti-Corruption Council was in position to analyze several amended versions of the text, and to consult with the Prime Minister's advisor as well, who was directly engaged on drafting the new law. The Council presented its opinion referring to the amendments of the Law in the letter to the Prime Minister of October 2007. The Council was not given a chance to analyze the final version of the Law before it was submitted to the Parliament, though it is hardly likely that something would have been changed at the last moment, as the Government had also ignored the previously presented opinions of the Council, except for a few less significant remarks. Consequently, by pointing out the weak points of the Law, the Council has no other option on this occasion but to recommend to the Government a change in some disputable provisions.

While analyzing the proposal for the amendments to the Law, the Council has identified two most outstanding weaknesses: (1) a tendency towards weakening the position of the Competition Commission and even dismissing the existing Commission because of the decisions it has brought against the interests of tycoons, and (2) the tendency of discretionary powers of the Government to be strengthened, as in every new version of the Law, it was additionally empowered to proclaim exceptions to the general rules of protection of competition. In one phase the proposals went so far as to secure a privileged position for the biggest car importers by the very provisions of the Law.

The adopted Law has partly compromised such tendencies: (1) the existing Commission shall continue its work until the election of a new one, but its position has been significantly weakened; (2) car importers are not directly mentioned among the exceptions from the prohibition of restrictive agreements, but the Government is empowered to grant special privileges, even without consulting the Commission as an expert body. If the Government is really under the spell of private interests as claimed by many observers of domestic circumstances, it will use the newly-acquired legal rights to grant privileged positions to interested tycoons (persons who have a privileged status with the executive branch), and that will soon come out.

Certain new provisions have improved the Law from 2005, referring primarily to the procedures conducted by the Commission and the measures it is authorized to pronounce (the extremely unrealistic solution according to which magistrates pronounced punitive measures for violation of competition was abandoned). According to the new Law, judicial protection is provided through proceedings before the Administrative Court, which will be established, and not, as so far, through administrative proceedings before the Supreme Court of Serbia (this solution has proved to be very deficient, which will be further discussed in this report).

Nevertheless, these solutions which are certainly an improvement, will not render positive results in practice as cases of violations of competition are still defined in an inadequate and often contradictory manner. Consequently, the Law still enables infringement of some of the basic rules of free market competition. There were too many such examples in the past, and the Council submitted reports to the Government on the

most drastic ones (e.g. the merger of “C-Market“ with "Novafin“, agreement on fixing the prices of “C-market“ shares, usurpation of the ownership over "Belgrade Port“, etc.).

The Council finds that the Law is one of the key elements in combating corruption. Lack of efficient protection of consumers and other participants in the market opens ideal possibilities for monopolists to make enormous profits, which make up major funds for bribing government and party officials. Privileges of monopolists may be various - from adoption of systemic laws which help them, through the use of special privileges in conduct of economic policy, and to particular legal acts in favour of tycoons. In this way corruption has become an endemic phenomenon in Serbia against which a comprehensive campaign has to be conducted. The Law on Protection of Competition has a special place in that campaign, as it can contribute by its provisions to curbing the economic power of monopolists and to the creation of conditions for a more equitable distribution of the results of economic competition.

No law by itself can deliver positive results if there is a lack of will on the part of the judicial and executive branches to apply it. Therefore, the Council recommends to the Government to extend full material and technical support to the judicial authorities, primarily at the time of the establishing of the Administrative Court, but also to the Commission for Protection of Competition, so that even on the basis of the existing legal rules minor steps in fighting monopolies could be achieved. Besides material and technical support, the Commission needs a clear political support, as it is trying to put a lid on monopolies, which are in the hands of the richest and the most influential people in this country.

Success in this struggle is easily recognizable and the voters will appreciate it, while failure due to a lack of political will will be only comprehended as an indicator of the existence of connections between the ruling parties and the richest people. Failure in fighting monopoly will be at the same time failure in fighting corruption, and a sign that the leading parties and their leaderships are not ready to give up their material interests for the benefit of the entire society.

The Council will focus in this report only on the most significant shortcomings of the Law and it will suggest necessary changes. This refers, primarily, to the purpose of the Law, the definition of the relevant market, the definition of the dominant position and market power, the concentration measures, as well as on the definition of the basic ~~cases of~~ violations of competition rules.

1. Aim of the Law

The best recipe for producing a bad law is when there is a lack of clear aim and objective of its adoption. This simple rule is also confirmed in the case of the Law on Protection of Competition. Obviously, the purpose of this Law was not clear to the legislator. This conclusion may be inferred from the very title of the Law. Competition is a process which is the result of many conflicting forces. Whether competition is going to exist or not in an economy depends on numerous factors and only some of them depend on the government action.

The blurred aim of the Law is clearly seen from Article 1, which defines the aim of the Law, according to which competition is protected "with the aim to improve the economic progress, and accomplish economic welfare for the society as a whole, particularly the consumers' benefit…", What economic progress is, and what is ~~the~~ welfare of the society; how are these categories measured, how will the court judge whether a participant has limited economic progress, or, again, diminished welfare of the society? Or, how to judge a situation when someone stimulates economic progress by his actions, and dwindles the social welfare at the same time, or vice versa? The answer to these questions is not found in the provisions of this Law.

It is disputable in economic science whether competition is really a precondition for economic progress, or, monopolies generate technological development, which improves material wellbeing of the entire society. Certainly, there is no place for disputable questions in a law, as in practice they may cause more damage then benefit.

On the other hand, consumers' benefit is somehow sidelined in provisions of the Law. The wording "and particularly consumers' benefit", appears as if suggesting that there were some other aims which are not explicitly stated. In other words, confusion has been created, which results from confusion in the heads of the authors of the Law.

Simply, the Law should be entitled so that it is clear to everyone that it is brought with an aim of combating monopolies (for example, Anti-monopoly Law or Law on Combating Monopolies). The aim of this Law must be the protection of consumers. The subject of the Law is the fight against monopolies, either on the side of supply or demand (monopsony). However, the Law must also give an answer to the question why monopolies are harmful? The answer is simple - monopolies restrict the quantity of supply and thus charge higher prices, and the consumers suffer considerable damage owing to that fact.

By abusing his market power, a monopolist actually makes redistribution from buyers to the seller. Consumers are compelled to pay higher prices because monopoly is just one seller on the particular market or dominates the market so that the other suppliers simply follow him. In other words, consumers have only one choice, either to buy or to decline buying the good. If they buy it, they will suffer damage which is equal to the difference between the monopoly price and the price which would exist if there were competition on that market. The amount of damage can be relatively easily calculated and an appropriate measure accordingly taken against the monopolist.

Many European anti-monopoly laws do not state these simple facts in their introductory paragraphs, but these facts should be clearly stated in our law because we live in a transition society which is just getting used to market categories and standards. One can easily understand the meaning of these words by referring to the rulings of the highest court in this country. For example, the Supreme Court of Serbia in its judgment in the UNIQUA REAL ESTATE versus the Commission for Protection of Competition case (U. 1595/07, Council President judge Jadranka Injac, MSc.), confuses the terms competition and concentration. Referring to the approval of concentration, the word competition is used as many as four times and concentration only three times. The three signatories of the verdict have not found anything strange in the wording "approval of the competition".

Emphasizing consumers protection in the introductory articles of the Law is also necessary owing to the legal rules applied in the European Union (EU). Nearly all EU documents referring to this matter put the interests of consumers in the forefront. Thus, on the basis of the Article 81 of the Treaty Establishing the European Community all preventions, restrictions, or distortions of competition are clearly prohibited, and exemptions are possible only if they contribute to improving the production or distribution of goods, or promote technical progress, and at the same time "allow consumers a fair share of the resulting benefit" (Paragraph 3). All agreements that would infringe this principle would be null and void according to the EU rules. The next article of the Treaty (82nd) prohibits abuse of a dominant position within the relevant market, again having in mind the interests of consumers.

Similarly, the rules applied in concentration control (Council Regulation No 4064/89), obey the European Commission to take into consideration market position of the concentration participants, "the interests of the intermediate and ultimate consumers, and the development of technical and economic progress, provided that it is to the consumers' advantage and does not form an obstacle to competition"(Article 2, Paragraph 1). Consequently, the basic criterion for approving concentration on the European market is whether it contributes to the interests of consumers or undermines them.

On the basis of this law, the European Commission has adopted Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements (2001/C 3/02). In the Paragraph 25 agreements which are almost always prohibited are listed (an exemption is made only in case of joint ventures), such as: restriction of competition by price fixing, limiting production, or sharing of markets or buyers. This is followed by an explanation why all these agreements are harmful: «price fixing and output limitation directly lead to consumers paying higher prices, or not receiving the desired quantities. The sharing of markets or customers reduces the choice available to consumers and therefore leads to higher prices or reduced output". The Commission considers such offences as the most harmful restrictions of competition and, therefore, sets the most rigorous fines for them in accordance with the Guidelines on the Method of Setting Fines (2006/C 210/02), Paragraph 23.

All these arguments confirm that it is necessary to point out clearly in one of the introductory articles of the Law that the aim of the Law is protection of consumers, and that the subject of the Law are actions which disrupt competition, causing damage to the end users of goods and services. Only after these changes courts would have a clear criterion for making judgments in cases which are not trivial and which may require significant knowledge of economic theory.

2. Relevant market

Defining the relative market is certainly of key significance for the application of trust legislation. According to the definition, competition takes place on a market, but only when we establish the limits of competition among companies, we are able to define the scope of a market, and then to calculate shares in the market supply, or market power of the participants. However, the question is how to define the market when there are so many products which satisfy the same need of the buyers.

A product which is widely used, such as soap, has a precisely defined use, but there are many different brands in the market which are sold at different prices. The price range may be wide and soaps produced by well-known companies may be as much as one hundred times more expensive than soaps produced by small domestic producers. The question is whether products of these two suppliers compete with each other, i.e. if they belong to the same market. If they really do not compete with each other, maybe this market should be subdivided. But where are then the limits to market division? Maybe we would get into a paradoxical situation to proclaim the products of each individual producer as a separate market, as, for example, it is not certain whether a producer of glycerin soap effectively competes with a producer of baby soap. If we opt for a wider scope of the market, maybe we shall have to include face cleaning lotions, liquid soaps, hand washing paste, etc. in the relevant market. An attempt to define ~~individual~~ particular market~~s~~ may be very complicated in some cases.

The new Law takes over the Article 6 from the previous Law and together with it the tautological definition: "the relevant market…is a market involving a relevant product market in a relevant geographic market". As this statement has no meaning, the following explanation is given in the ensuing text: "The relevant product market is a group of goods, or services which consumers consider substitutable from the point of view of their characteristics, intended normal use and price". As this explanation is not much better than the previous statement, it is stated at the end of the Article that the Government shall prescribe the criteria for defining the relevant market.

Indeed the Government has brought an Order on the Criteria for Defining the Relevant Market (Official Herald of the Republic of Serbia No. 94/2005), which is still in force in spite of the adoption of the new Law. Nevertheless, this Order is no more useful than the very Law provision as it is an abridged and poor translation of a foreign text. In Article 2 it says: "The relevant market is defined by the application of a test of small, but significant and permanent increase of prices by hypothetical monopolist... The test of hypothetical monopolistic increase of prices includes defining of the narrowest market for particular goods or service where the hypothetical monopolist could profitably apply a small, but significant and permanent increase of prices". The relevant market is defined by a test by which the market is defined. Who has understood, he will know.

Of course, the highest court in the country could not understand the above definition of the relevant market and how to establish its scope. Thus, in the case *Imlek* and *Suboticka mlekara* (both owned by the *Danube Foods Group*) vs. the Commission for Protection of Competition (U.1395/08, the Court Council President judge Zoja Popović), the Court stated that the Commission had not defined the relevant market. "The Government of the Republic of Serbia has brought an Order… by which it has prescribed the criteria for defining the relevant market (the test of assumed monopolistic increase of prices, assessment of the level of decrease in demand on the product market, assessment of the level of decrease of demand on the geographic market, etc.)". The Court Council did not understand that all that was stated in the brackets is one and the same thing. It could not (or did not want to) understand the position of the Commission according to which it was not possible to apply the test "as fresh milk is not substitutable by any other agricultural

product, and dairy plants have no competitors in purchasing milk”. The Supreme Court was decisive that "the law was violated against the plaintiff".

A more drastic example is the verdict, which has more serious consequences, in the case of “Primer C” vs. the Commission. The Court Council (presided by the judge Danica Bogdanović), overruling the Decision of the Commission preventing the establishment of a monopoly in Belgrade retail trade, stated that the relevant market was not defined correctly. At the same time, no arguments were given in the judgment, but the only reference which was made to a “very detailed Analysis of the Situation” prepared by the Chambre of Commerce of Serbia and “Conzit”, as well as to the Study “prepared by the Faculty of Law of the University of Belgrade".

It appears as if the Court did not want to discuss the issue it considered very technical and beyond comprehension. It was easier to refer to the “authorities”. This statement is nothing but strange, as the Court was well informed that the very same company which tried to establish monopoly in trade and whose owner was the richest man in the country had ordered both studies. The institutions to which the Supreme Court referred to were only used as a screen for hiding the lucrative interests of the authors of the ordered "analyses" (Slobodan Milosavljević, in case of the Chamber of Commerce, the Dean Mirko Vasiljević with a group of professors of the Faculty of Law, consisting of Boris Begović, Vesna Besarović, Dragor Hiber, Gašo Knežević, Vladimir Pavić).

It appears that the Supreme Court could not have been able to refer so easily to the “authorities” if the relevant market had been precisely defined in the Law and if the Order had specified the procedures for defining the relevant market. The lack of clear legal regulations and disrespect of those regulations which are clearly stated has led to the creation of a monopoly in the retail trade, to the asset striping, and to the factual expropriation of the small owners, about which the Anti-Corruption Council has informed the Government on a number of occasions (reports on the privatization of C-Market).

The notion of the relevant market has been precisely elaborated in professional literature and it differs somewhat from the intuitive understanding of the words combined in this way. For example, in the ordinary speech there is no dilemma what the relevant market is for apples – it is the market of apples on a particular location. However, owing to the differentiation of products, a need aroused in the judicial practice, primarily in the United States of America, to have a more precise market definition. The European Union officially adopted the American approach only in 1997, though some member countries had applied the same concept before.

Nowadays it is usually considered that a group of products on a certain location would make up a market only if sellers, acting as a monopoly, would be able to make a profit by the price increase. If there is competition on a market, the sellers “discipline” one another – neither can raise the price because buyers would turn to other sellers who have not raised the price. Unlike this, a monopoly encounters the whole demand on the given market and, therefore, it can set a price which is the most suitable for him. Thus the boundaries of the market are established indirectly, through a hypothetical question: whether the selling price of a group of products held by a monopolist could be raised and

consequently increase the profit? The relevant market is the smallest group of products which meet the described criterion.

The procedure for defining the relevant market is iterative. One starts from a product and then adds up the closest product to it which meets the same need (a substitute), until a group of products emerges whose price could be raised and profits collected in spite of reduced sales (it is realistic to expect that increased prices lead to a decrease in sales).

If we go back to the example with apples, the question is whether only one sort or more sorts of apples make up a market, or whether some other fruit should be added to the apples (strawberries, plums, or all fresh fruits). Let us say that in a certain location there are several sellers of Delicious apples. If they acted together, whether they could behave as a monopoly, raise the price and make a profit? The probable answer is negative, as the buyers would easily switch to other sorts of apples. Therefore, we shall add Jonagold apples to Delicious apples. Could the sellers of Delicious apples and Jonagold apples raise the price and make a profit, acting as a monopoly? If the answer is still negative, we should add a new sort and thus we expand the notion of the market until we possibly include all sorts of apples. If the sellers would not be able to raise the price of their products profitably still, the conclusion is that apples alone cannot make a relevant market. The closest substitute should be added to them, and these are, for example, pears. Could the sellers of apples and pears, acting as a monopoly, raise the price and make a profit? If the answer is positive, then these two products make up the relevant market. If the answer is negative, we should add the next closest substitute, until we get a positive answer.

Having in mind this, we can say that the Commission acted properly in the case of “Imlek”, when it established that “there was no other agricultural substitute product for fresh milk on the given location” and therefore, it makes the relevant market. Had the relevant market been precisely defined in the Law, the Court would have had to accept the ruling of the Commission. Then the plaintiff would have had to prove that milk producers would not have been able to raise the purchase price of milk if they acted as a monopoly on that market. That task would be practically impossible. Thus, by a court decision, one more monopoly, owned by tycoons, obtained the right to continue abusing its dominant position on the market and to make abnormal profits through it.

The following two types of information have the key significance for defining the relevant market: the fall in demand due to the increase of its own prices and the fall of demand due to the increase of price of some other product. The first phenomenon is described as the coefficient of own price elasticity (percentage decrease in quantity of apples purchased, due to the one-percent increase of their own price), and the other is described by the cross elasticity of demand (percentage increase of the sales of apples due to the one-percent increase of the price of pears). If the increase of price of one product increases the demand for another, making consequently the coefficient cross elasticity positive, the products are interchangeable in consumption (substitutes). Therefore, products in a decreasing value of the coefficient of cross elasticity of demand are sequentially included in the relevant market.

It is clear that the authority establishing the scope of a relevant market (Commission for Protection of Competition) must have a very detailed information about prices and sold quantities, but also on the number, economic power, capacity of the competitors, possibilities for the appearance of some new competitors, either foreign, or domestic companies. Therefore, it would be useful to enumerate in the Law government bodies which must regularly send all necessary market information and analyses to the Commission (Statistical Office, Customs Office, ministries of economy, finance and trade), as in the German Law.

Defining the relevant market is just the first step in the analysis of the enterprise market power. Market power is defined as the ability of ~~the~~ seller (buyer) to keep the price above (below) the competitors' price, enabling him to make an extra profit. According to our Law, market power is not defined at all, but only the notion of the abuse of the dominant position is ~~used~~ set forth.

3. Dominant position

The market position of a seller is usually established by identifying his share in the total market sales. It is assumed that a seller with a greater share may make a greater influence on the price level. Our Law defines the dominant market position threshold as a market share of 40% (Article 15). This limit is set rather high. For example, the German Law points out that dominant market position is acquired with one third of the market share, while most European laws follow the position of the European Commission, according to which it is impossible to set a right threshold for market domination because of specific forms of competition in particular markets (Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements, Paragraph 28, 2001/C 3/02).

The Article of the Law defining market domination does not specify precisely the method how the market share of enterprises is calculated. It probably refers to the share of an enterprise in the total sales on the relevant market. Article 7, which defines the method of calculation of total revenues, suggests such an interpretation. However, the share of an enterprise in the total sales on the relevant market need not correspond to the significance of that enterprise in the market competition.

Let us examine a simple example: there are two tomato producers, and one of them specialize~~s~~ in early season vegetables, and the other for sale in full season. The first sells 10 kilograms at a price of 200 Dinars, and the second 100 kilograms at a price of 20 Dinars. Both of them have the same revenue – 2000 Dinars – and on the basis of that indicator solely it could be concluded that their market position is identical. However, the second producer has ten times larger production. This fact may be decisive in some situations, depending on the type of competition that dominates the industry (Cournot's competition – when competitors adapt-to quantities, or Bertarnd's – when they adjust to the price).

Having in mind limited informational content of the total revenue of competitors, the Commission acted correctly in the case "Primer C" (Decision No. 6/0-02-138/07/15, dated 26.11.2007), when it assessed market position of the trading companies, not only by calculating the revenues and shares in the sales of particular items, but also by comparing the number, area and ~~the~~ type of the selling space. Likewise, in the

proceedings conducted against the Dairy Plants owned by the *Danube Foods Group*, the Commission cross-checked the information of the Ministry of Agriculture with data of the Association of Cattle-Breeders on the number of companies purchasing milk and the quantities of milk purchased in order to discern dominant position of the participants (Decision 5/0-02-66/08-1, dated 25.1.2008). In addition to that, the Commission calculated, although it was not obliged to do so according to the Law, the degree of market concentration in both cases and established that it was high according to the European standards. Nevertheless, all these arguments were not convincing enough for the Supreme Court, and it stated in the verdict that the existence of the dominant position "was not adequately and fully established" by the Commission (U.1395/08).

The share of the company revenue in the relevant market sales is just one of the indicators of the company position, but definitely not the most important one. For example, there may be one seller on the market whose share is 40 % and 20 smaller ones, each having a share of about 3 %. On another market an enterprise has also a share of 40 %, but there are two more sellers who cover 30 % of the demand each. The position of the dominant sellers on these two markets is quite different. In the second case, it can hardly be claimed that the biggest seller has a dominant position indeed. Consequently, the share of each competitor is a significant indicator, as it is necessary to calculate the degree of concentration of supply, but equally important is the type of the competition that dominates the relevant market, which is not mentioned in the Law at all.

The degree of supply concentration can be measured in different ways, but the most commonly used method today is calculation of the Herfindahl-Hirschmann-Index (HHI). It is widely accepted that this Index shows the extent of competition and its position in an industry in the best way. It is calculated as the sum of squared market shares. In case when there is only one seller on a market, the value of the Index is 10000, which is the highest value (100^2=10000), and with the growth of the number of competitors this Index falls towards zero. According to the EU rules (Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements, 2001/C 3/02), it is established that degree of market concentration is low if the index value is below 1000; market concentration is moderate if the index value is between 1000 and 1800, and if it is higher than this figure the degree of market concentration is high (Paragraph 29).

In the first case of the previous example, the index would be 1780, which would indicate a moderate degree of market concentration, in spite of the fact that the biggest seller is by far the most powerful on the market. In the second case, the degree of concentration would be very high, with the index of 3400 points, in spite of the fact that the biggest seller is just somewhat more powerful than his competitors. On the basis of the above example it can be seen that the HHI method is not a perfect indicator of market domination. That is why the US Department of Justice and the Federal Trade Commission have determined that in case of a merger not only the absolute HHI has to be calculated, but also its increment (Horizontal Merger Guidelines). If, in a zone of moderate concentration, the HHI is increased by more than 100 points after a merger and in the zone of high concentration by more than 50 points, the government authorities have to react. Nothing of that is included in our Law.

Let us consider in more detail how the Law defines the dominant position: "An enterprise which has no competitors or its competition is insignificant, or which has a much better position than its competitors has a dominant position on the relevant market…" (Article 15). First, it is difficult to find a seller who has no competitors in a small country which is open to the world trade. Even in the case of a natural monopoly, and with the state control of imports, whereby EPS (Electric Power Distribution Co. Serbia) is the best example, consumers may choose whether to use electrical power, heating oil, coal, gas or firewood for heating. Household heating does not account for a small part of electrical power consumption and EPS must take it into consideration. Or the government may grant a legal monopoly to a company, as it has been done with petrol, but competition may also very easily appear on that market in the form of black market if the monopolist raises the price too much. Practically, an example of a monopolist without competition would be only some small shop in a remote village. Nevertheless, there may be also some substitution after all: villagers may bake bread on their own if they find the price of bread in the shop to be too high, and once a month they may go by car to the nearest bigger place in order to buy all necessities. However, the Commission for Protection of Competition is not to deal with such cases.

Let us consider another envisioned case - insignificant competition. The Law does not provide a criterion for differenti~~at~~ing significant from insignificant competition. What is the limit after which the competition becomes insignificant in a market, whether a share of 90%, 95%, 85%, or just the legal minimum of a 40% share? We have seen in the above example that the last criterion for declaring the existence of insignificant competition would not be acceptable, as the dominant seller may have several competitors who sell on the relevant market just a little less than he does does. Moreover, in the case when one seller meets nearly all demand, as, let us say, the National Postal Service does, by delivering nearly all written letters, it still does not mean that there is insignificant competition, or even the dominant market position of the Service. In fact, people decreasingly write letters in order to communicate, and switch to electronic exchange of information.

The Law envisages the third possibility for domination in the case when a company has significantly better position than its competitors. Like in the example with the letter delivery, a newspaper publisher, such as Politika, may have significantly larger circulation of daily newspapers than all its competitors, and a much greater economic and financial power. However, it may have a small market power, as people read news and comments on the Internet free of charge. That would practically mean that Internet should be included in the relevant market, but reading newspaper articles is not charged as a separate Internet service, and therefore we can establish the market share of Politika only on the basis of printed media which have a selling price (some daily papers are distributed to readers free of charge). According to the criteria from the Law, the daily paper Politika has a dominant market position, but it means very little in practice.

The Law does not prohibit the existence of a dominant position, but the abuse of such a position (Article 16). Four types of abuse are specified, out of which the first two cases are absolutely obscure and inoperable. The Law distinguishes the first basis for the abuse of the position in fixing an "unjust purchase or selling price or other unjust business

operation conditions". However, no criterion how to distinguish a fair from an unfair price, or how to distinguish just from unjust conditions of business operation is given. Thus, it is left to the competitors on the market to freely assess what is fair and what is not, which is practically a public call for flooding the Commission with complaints about "unfair" prices or unjust business practices. In a law promoting competition, it is not justified to use ethical value judgments, because they result from subjective reasoning.

The Law distinguishes the second basis for the abuse of dominant position in restrictive practices in production, marketing, technical development. No criteria how to distinguish normal situation from the restrictive one is given. For example, companies rarely, even in prosperous times, use their capacities one hundred percent. Does it mean that all companies restrict production and that they should be prosecuted (or at least those companies which have a share in the sales higher than 40%)?

The dominant position of enterprises and the abuse of this position are inseparable from the concept of market power, but there is no mentioning of it in the Law.

4. Market power

A seller (buyer) who can sell (buy) at a price which is higher (lower) than the competitive price has a market power. The competitive price is, on the other hand, equal to the costs of the most expensive unit necessary to meet the demand (marginal costs). Actually, the equilibrium on a competitive market is established at the intersection of aggregate demand and aggregate supply functions. The latter function is calculated by adding the marginal costs of the existing suppliers (additional costs of bringing one extra unit to the market). Since under competitive conditions marginal costs must rise, the equilibrium price is equal to the marginal costs of the last unit offered on the market. That price represents also the readiness of buyers to pay for the last offered unit of a good or service. If a seller is able to raise his price by limiting the supply and thus make a profit, he has a market power.

Market power is most frequently shown as a percentage deviation of the marginal costs from the price (the Lerner Coefficient). If p is the selling price, and MC marginal cost, the market power is shown by the following formula:

$$L = \frac{p - MC}{p}.$$

It can be easily proved that ~~the~~ market power is inversely proportional to the coefficient of the demand elasticity. If the demand elasticity is high, the difference between the prices and the marginal costs is small, and consequently the market power of the seller is small.

On the other hand, a buyer who has the market power is able to bring down the price by restricting his purchases and thus make a profit. His market power is equal to the reciprocal value of the coefficient of the supply elasticity (percentage growth of the supply due to a one-percent increase in the selling price).

These criteria have a very simple explanation: if the demand elasticity is high, a small increase of the selling price by one seller shall cause a great fall in demand for his

products and, therefore, such an action will not be profitable. Contrary to that, in case of low demand elasticity, one seller may significantly raise his price, which is followed by a small decrease in demand, and consequent increase ~~of~~ in his profit. There is an analogous relationship between the market power of a buyer and the supply elasticity function. Therefore, if one knows the elasticity coefficients of demand and supply a lot may be discerned on the market power of enterprises.

Of course, knowledge of the coefficients of the demand and supply elasticity is just the first step in examining the market power of an enterprise. Further analysis requires the knowledge of reactions of competitors to supply restrictions and the consequent increase in the selling price. It can be easily concluded that the demand elasticity for the products of one seller, or his market power, depends on the elasticity of demand, on the supply elasticity of his competitors, and on the share of the particular company in the total sales on the relevant market. Lower demand and supply elasticity and a higher market share mean greater market power.

The response of competitors substantially depends on the type of products offered on the market (homogenous or differentiated), on the type of competition among the suppliers (Cournot's, Bertrand's, or Stackelberg's), as well as on the power of the buyers. Therefore, these aspects may not be disregarded in any attempt to circumscribe market power, which is proved by the rulings of the European Commission as well (Guidelines on the Applicability of Article 81 of the EC Treaty to the Horizontal Cooperation Agreements, Paragraph 30, 2001/C 3/02).

Market power of undertakings can be also measured by the critical loss analysis. Namely, the very fact that a seller is making big difference between the price and the marginal cost need not mean that he is in a position to raise the price of his products, i.e. it does not mean that he is able to effectuate his market power. The critical loss analysis is often applied to the definition of market boundaries, but it is also applied to the analysis of the merger effects. It should give an answer to the question whether a company, resulting from the merger, will be able to raise the price of its products and thus abuse the acquired market power.

The critical loss analysis starts from a justified presumption that a hypothetical monopolist (a group of products on a market) can raise the price of its products, which inevitably leads to a decrease in quantity. However, the decrease of sales is associated with a decrease in profits, as the difference between price and marginal cost in that case is multiplied by a smaller quantity (the seller already had certain market power before the increase in price). On the other hand, the total revenue is probably increased by the increase in prices. Consequently, each raise of prices results in certain increase of the revenue, but also a loss of profits, due to decreased sales. The critical loss is a percentage decrease of ~~the~~ sales by which these two different trends are equalized. If ~~the~~ critical loss is marked as K, the following will be the formula for its calculation:

$$K = \frac{\Delta p / p}{L + \Delta p / p},$$

where p represents ~~the~~ price, Δp is its change, and L is the Lerner Index.

If a hypothetical monopolist actually reduces his sales in a smaller percentage than the critical loss, an increase in prices would pay off. However, if actual decrease in sales is higher than the critical loss, such an action would not pay off. In other words, an increase of prices pays off only if the actual loss in sales is lower than the critical loss.

With the knowledge of the Lerner Index (which is equal to the reciprocal value of demand elasticity), it is easy to calculate the critical loss. It goes in the opposite direction from the Lerner Index, and a growth of the Lerner Index leads to a decrease in the critical loss, as the Index is in the denominator of the above expression. With the growth of the profit margin (the difference between the price and the marginal cost), i.e. with the growth of the market power of an enterprise, the critical loss decreases. But with an increase in demand elasticity, the critical loss grows also, since rising demand elasticity reduces the Lerner Index.

An example may illustrate the stated positions. Let us assume that a seller has a significant market power, as his selling price is two times higher than the marginal cost. Then the value of the Lerner Index is 0.5. The question is if this seller has the ability to increase the selling price by 5 % and make a profit in that way, ~~if~~ as the demand elasticity for his products is 2. The data on the demand elasticity show that the 5 % increase in price will cause the demand fall by 10 %. By applying the formula for the critical loss, we get the greatest percentage decrease of sales that does not change the amount of the profit:

$$K = \frac{0.05}{0,5 + 0.05} = 0,0909 .$$

The result shows that the seller may afford a decrease of his sales by 9.09% at the most, if he does not wish to accrue a lower profit. As an increase of the price by 5% would reduce the sales by 10%, he certainly would not raise the price. If this analysis is applied to the hypothetical monopolist case, a conclusion would follow that the market has been narrowly defined, and that more substitutes should be included in the relevant market. Further broadening of the relevant market will lead to further decrease of the individual share in the market by ~~of~~ each competitor.

As the analysis of the critical loss is a standard instrument which is applied in courts in countries with developed antitrust legislation it is necessary to include this notion in our Law as well.

5. Price fixing

One of the most serious violations of free competition rules refers to price fixing, when two participants on a market make an agreement on the price a third participant is to pay. The freedom of contract is restricted by this deal since the third participant is not in position to freely express his will on the price as the most important element of a sales contract. The agreement of the first two participants is certainly at his expense - if he is a buyer, he will pay a higher price and if he is a seller, he will get lower revenue from sales.

Price fixing is a wider concept than formation of cartels. In fact, a cartel is a coordinated effort by two or more participants on the side of supply or demand, when they, by a formal or informal agreement, manage to get a better price for themselves. In some situations, participants in a price fixing agreement do not have to appear on the relevant market at all, in spite of the fact that their word is decisive for fixing the price to be paid (received) by the third party which is not a participant of the deal.

An example of such price fixing was the case of the agreement made by the representatives of "Delta M", C-Market" and "Laderna" on the price to be paid by "Primer C" to the holders of “C-Market” shares (it was fixed at the amount offered by “Delta M”, which did not appear as ~~the~~ a buyer of the shares). By the same agreement the parties who were not ~~the~~ buyers of the shares agreed on the interest share in the ownership “in the project of” takeover of “C-Market”, which is usually qualified as a division of market (the Anti-Corruption Council informed the Government about this case in the letter of 20 August 2007).

In Article 81st of the Treaty Establishing the European Community price fixing is stated as the first form of competition prevention, following the priority given to this form of violation of the free competition rules in national legislations of member states. Such agreements are prohibited and considered null and void by all antitrust laws, and participants in such agreements are accordingly punished. In France, for example, besides a fine (relatively low), a fixed four-year imprisonment is stipulated (Trade Code, Article L 420-6). Similar rules are applied outside Europe as well. In the United States, parties suffering harm by such agreements may claim treble damages, and a jail sentence of up to three years is threatened to participants of the agreements, deterring potential conspirators from violating the competition rules.

Our new Law has defined the price fixing by a very awkward translation from English. It is stated in the Article 10 that restrictive agreements are those agreements by which “purchase and selling prices or other trade conditions are indirectly or directly determined”. Literal application of these words would mean that all sale contracts are restrictive and as such null and void. In fact, the purchase or selling price is fixed by each sale contract, as a necessary part of the deal. The wording has failed to specify that the conditions are fixed for someone else, i.e. for someone who is not a party to the agreement. A penalty up to 10% of the annual income is threatened for this type of violation of competition rules.

Penalties for this type of offence are rather high and therefore the Law has stipulated a possibility that an appeal against the decision of the Commission may be filed to the Administrative Court (Article 71). However, the Law does not specify the criterion, which can be used either by the Commission or by the Court, for price fixing reveal. In this way, the provision of the Law is, besides wrong definition, simply an empty threat, and therefore, it is realistic to expect that in the future monopolists will keep on dividing markets and fixing prices for other participants in the trade.

6. Conclusion

Out of twelve recommendations which the Council had sent to the Government during the preparation of the amendments to the Law, only two have been accepted, but rather

partially (the procedures before the Commission and its executive orders). However, some amendments to the Law are directly contrary to the recommendations of the Council (the weakening of the Commission relative to the Government). Within those provisions that weaken the position of the Commission, especially striking is the possibility of replacing a Council member or even the Chairman of the Commission by a simple vote in the Parliament, after a recommendation by a Parliamentary Committee (in the previous Law a proposal for impeachment had to be submitted by a minimum of 20 MPs at a plenary session of the Parliament).

Some new provisions in the Law have certainly contributed to its improvement. This primarily refers to the possibility of deconcentration, especially in the situation when a merger is conducted without an approval by the Commission. The previous Law explicitly prohibited such a measure, jeopardizing the very purpose of the existence of an antitrust law. Such a legal solution, in combination with the penalty policy which was to be conducted by magistrate courts, was a direct call for degradation of the Commission credibility. The most drastic example from that period is undoubtedly the merger of "Primer C" and "Novafin" contrary to the decision of the Commission. Soon upon the completion of the merger, the company "C-Market" was practically closed, and its assets stripped. The attitudes of the Commission were simply ignored. Now there is at least a legal possibility of deconcentration, but the procedures have remained underdeveloped, so that there is still significant doubt about the enforcement of such a measure.

The general assessment of the Anti-Corruption Council is that the Government did not have sufficient professional capacities that would enable adoption of a good antitrust law. This assessment primarily refers to defining of the relevant market, the dominant position of companies, price fixing, as well as to defining the abuse of the dominant position. The legal provisions totally neglect the measures related to the supply concentration and the measures related to the market power of enterprises, which are in standard use in developed countries. It can be openly stated that struggle against monopoly with such a Law will be similar to fighting against windmills. The antitrust policy will continue groping in the dark due to contradictory and unclear regulations. Even if we assume that the Commission will preserve its independence and that it will, as it has done so far, analyze the monopolistic position of enterprises of its own accord, it cannot make any progress without a legal basis for its actions. Such decisions of the Commission will be easily overruled in the court, with or without an "expert" opinion, and especially in an atmosphere in which it is not advisable to oppose political and economic power centers in the country.

The fact is that some basic concepts discussed in this report, such as the relevant market, demand and supply elasticity, the critical loss analysis, etc, are not defined in many European antitrust regulations. But, in European and American judicial practice, these concepts are quite legitimate. In this country, only a limited number of people are familiar with these terms, which is also reflected in the verdicts of the Supreme Court. Therefore, it is necessary for this Law to be more elaborate comparing to the antitrust laws in developed countries. Simple copying of their provisions, usually inadequately translated, can make more damage than benefit. The Anti-Corruption Council recommends that a more serious and precise antitrust law be written, as struggle against

corruption without it is directed to the consequences and not to the causes of this damaging phenomenon.

In Belgrade, on 16 November 2009.

PRESIDENT

Verica Barac