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## **Problems of Monopolization and Antitrust Policy in Transitional Economies (on the example of the Republic of Armenia)\***

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**Abstract:** Numerous fields of Armenian economy are either monopolized or have high level of concentration. That's why the development and realization of effective antitrust policy is an urgent problem in RA. For that purpose first of all it is important to develop concept of antitrust policy mentioning the main directions of its implementation. This research is devoted to the mentioned issue. For that purpose is made an attempt to describe formation process of monopolies in transitional economies and monopolization level of Armenian economy and to determine actual directions of improvement of antitrust regulation. According to the major findings of the research, only a well developed antitrust strategy can bring to the formation of free competition. In this research is made an attempt to develop a concept of antitrust policy, that can be applicable not only in Armenia, but in all transitional economies. Of course, in different transitional economies it can be put into practice taking into account the idiosyncrasies of the development of their economy.

**Key words:** Monopoly, monopolization, antitrust policy, product markets, protection of competition, small and medium business

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### **INTRODUCTION**

The antitrust regulation of economy is especially crucial in transitional societies, where the administrative form of economic activity is gradually transformed into self-regulation mechanism of market relations, while insufficient level of competition hinders from establishing stable rates of economic growth and efficient redistribution of income. The resolution of problems concerning the formation of competitive environment and antitrust regulation would create the necessary conditions for efficient business activity, improvement of investment environment and for establishment of regular relations with and within different markets.

Generally a number of transitional economies are characterized with high level of monopolization, as in those countries which economies were developing in administrative form during a long period of time the monopolization level is much higher then in countries with historically formed market economy. That's why the well developed antitrust policy is an urgent problem especially in those countries.

The problems of antitrust policy in RA are not still investigated and this is the first attempt to develop antitrust strategy for that country. In that concern will be made an attempt to reveal problems of monopolization and antitrust policy in transitional economies, particularly in the RA. Afterwards we shall try to develop mechanisms for reducing monopolization level and effective antitrust policy implementation. For this purpose will be analyzed characteristics of antitrust regulation, will be described formation process of monopolies in transitional economies and monopolization level of Armenian economy and will be determined actual directions of improvement of antitrust regulation.

In this investigation descriptive and logical methods, systematic approach and method of analyzing statistics will be used.

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### **MONOPOLY, OLIGOPOLY AND MARKET POWER IN ANTITRUST POLICY**

The alleged purpose of antitrust policy is to foster competition. The popular fear is that without them monopolies will restrict output, drive up prices and thereby gouge the consumer.

Monopolistic positions are usually treated in antitrust analysis under the traditional static criteria of microeconomics, implying for a maximizing monopolist higher prices and lower quantities as compared to competitive levels, which for simplicity are assumed always to be the relevant standard. Market power is accordingly defined as the ability to set prices above marginal and unit costs so as to maximize profits at above normal rates. As a result it allows the monopolist not only to earn an additional part of the consumer surplus but also to cause a net welfare deadweight loss to society. Monopolistic positions are therefore supposed to detain and more or less automatically to exercise, such discretionary power over prices, since it corresponds to act rationally under conventional assumptions.

Oligopolistic markets receive a similar treatment. An old tradition in oligopoly analysis possibly tracing back to Chamberlain assumes that rational oligopolists should in principle jointly maximize profits and thus set monopoly prices, unless prevented by some serious coordination problem. The progressive incorporation of uncooperative game theory in the analysis of strategic interaction under oligopoly made it possible to reformulate the problem with stricter analytical tools. Price rigidities above competitive levels, for example, may be explained by tacit price collusion procedures through focal points (conventional prices) or by price leadership, even under strictly uncooperative individual behavior principles, although the precise price level remains essentially indeterminate and subject to a mix of structural and behavioral influences. Whatever this level may be, concerted strategies are always assumed to be present and substantially higher than competitive prices to prevail, entailing allocative welfare losses to society just like monopolies. Accepted exceptions are only the so-called natural monopolies or oligopolies, resulting from high minimum efficient plant sizes relative to market sizes. Such cases are generally tolerated as a sub-Paretian fatality that cannot be eliminated but only corrected through public price regulation to keep prices just above unit costs.

Throughout this analytical framework a static focus on prices is pervasive. As Schumpeter argued, restrictive conducts conventionally associated to large companies (either monopolistic or oligopolistic) are frequently just a moment, often temporary, of a much broader competition process of creative destruction of existing economic structures. Patents and other legal mechanisms of temporary and conditional protection to monopolistic positions associated to intellectual property are not substantially different from other defensive procedures, not explicitly recognized by law, aimed at preserving competitive advantages reached through innovative efforts which often (although not always) entail an increase in welfare in dynamic perspective. To prevent such monopolistic gains of being quickly exhausted by easy imitation and early diffusion is a necessary condition to ensure adequate economic returns to successful investment in innovative activities, so as to stimulate larger flows of such investment and resulting dynamic welfare increase effects. To distinguish between such cases and mere abuse of a monopolistic position is not an easy task, where no simple, general and operational rules are to be found, but it would be better to antitrust economics to acknowledge the problem in order to face it than to ignore it. A last comment on the distinction between monopoly and oligopoly situations may be useful. Although old fashioned and lighter approaches to oligopoly tend to reduce it to a monopoly equivalent in terms of potential market power and welfare loss, an increasing part of antitrust economics tend to assume a somewhat more indulgent view, based not on the simple number of competitors but on a qualitative distinction between the two market forms.

As modern contributions to industrial organization have shown, efforts towards tacit collusion are very complex and often fail due to the difficulty of preventing free riding and of coordinating focal price or price leadership. From a dynamic Schumpeterian standpoint, however, it is important to add the extreme difficulty or even impossibility of preventing rival innovative competitive efforts, or innovative free riders, capable of breaking attempts to coordination aiming at the stabilization of market structures, in oligopolies whose patterns of competition involve substantial innovative dynamism.

### **CASE STUDY OF ANTITRUST POLICY**

In a market economy, economic relations are regulated through market forces: however this does not imply that the government should refrain from certain regulatory activities. There is no single country where the market is pure. At the micro level, government regulation is manifested in the functions of regulation of monopolies and protection of competition. The balance between monopolies and competition is one of the crucial issues for economic policy. Historically, the experiences of different countries tend to show a preference for one or the other. For example, the first antitrust bills adopted in the USA (in 1883, Alabama, in 1887 Kansas and in 1890-the federal Sherman Act (Zhidkov, 1963)) were primarily directed against monopolies. Western European countries, on the other hand, specifically Germany before WWII opted for monopolies, encouraging the operation of cartels and syndicates.

What was the basis for such discrepancies in approaches to monopolies? First of all, the US, having a larger territory than European countries, offered more opportunities for monopolies to prosper (rich natural resources and huge investment opportunities, extensive labor supply, higher levels of concentration of production, etc.) Faced with powerful employers, the influential trade unions forced the government to place certain limits on monopolistic activities.

In Europe, cartels weakened price competition in the sectors and industries they operated in, which, in turn, stimulated the flow of capital from other industries into cartel-dominated industries, which offered higher returns. Consequently, these sectors, although temporarily, would prosper and grow fast. This is why the European countries, first of all Germany (The Law on Fighting Unfair Competition adopted in Germany in 1957, amended in August, 1998), opted for regulating monopolies rather than fighting them.

After the WWII, Germany, on the insistence of the US, moved its antitrust legislation towards the US model and so did Japan (Nikitin, 1994). Though so-called democratization of the economy the US aimed at depleting the economic power of Japan and constraining the economic development of its competitors. Namely, the 1947 Law on Banning the Private Monopolies and Provision of Fair Transactions, developed for Japan by the Antitrust Division of the Ministry of Japan by the US, was even more strict and intolerant to monopolies than the respective law for the US. It prohibited cartel arrangements for fixing prices and efforts to control markets, as well as for the reduction of production.

It also prescribes less than five percent of total company shares to be owned by a financial institution. It banned company mergers and board mergers if it would lead to significant reduction of competition (Nikitin, 1985). The first years of the enforcement of this Law proved that it contradicted the national goals and constrained the development of Japan. And in 1953, after the change in the political regime in Japan, all the provisions of this Law containing requirements that constrained the development of key sectors were amended or eliminated.

The Law was amended to exclude the clause on obligatory division of monopolist companies. Anti-crisis cartels were allowed, merger restrictions were softened and financial institutions were permitted to own up to 10 percent of other companies' shares (Ivanov, 1980). Thus, the antitrust legislation was changed substantially; now it only contained regulating clauses.

The US put even higher penalties on monopolistic transactions during the high-inflation years in 1970 (Kovacic, 2002). Contrary to this, the European Union countries, in order to encourage exports

of goods and capital, introduced more favorable conditions for export crediting. The United Kingdom maintained low interest rates during 1967-1974. European countries also provided tax holidays to exporting monopolies: re-investing companies in Belgium were not tax levied at all. Nor were the exporters in France and Netherlands (Ivanov, 1976). The legislation of European Community countries does not prohibit monopolies rather it prohibits abuse of monopolistic powers, i.e., such behavior of monopolies that destroy market stability.

What should be the antitrust legislation in Armenia? Which model, European or the US, is more favorable for us? The Law on Protection of Economic Competition adopted by the National Assembly on November 6, 2000, resembles more the pre-WWII German legislation.

The same mechanism regulating concentrations is prescribed (through licensing the declared concentrations). Anti-competitive agreements are treated relatively softly (agreements are viewed anti-competitive if the total market share of participants exceeds 20% of the entire market, while the former German legislation provided a lower ceiling). In other words, current Armenian legislation is consistent with the European model (Rome Agreement, Article 86, part 1). It is directed to protecting competition not through fighting monopolies but by restricting monopolistic activities.

When developing a government policy on protecting competition it is important to bear in mind that during Soviet era, a large share of the production of big industrial plants in Armenia was sold outside Armenia. Consequently, these producers also dominate in the domestic market. Thus, they should be treated by the government in a dual manner. On one hand, these companies need to be subject to the government regulation not to leave room for abuse of their position in the domestic market; on the other hand, they need to gain new markets outside Armenia. The same approach should be taken for the newly-emerged monopolies, whose production needs to become competitive in foreign markets.

## **IDIOSYNCRASIES OF MONOPOLIZATION AND CONCEPT OF ANTITRUST POLICY**

As a rule, in those countries which economy was developing in administrative form during a long period of time, the monopolization level is much higher than in countries with historically formed market economy. In a market economy monopolies are formed in the result of strict competition fight, which brings to concentration of the capital. In administrative form monopolies are formed by upstairs (state bodies). State authorities have actively promoted increase of monopolization level. That's why in transition economies the role of counter-monopolization is much higher, than in countries with developed market economy.

In transition economy competitive environment is forming under the influence of reforms performed by state bodies. The latter means that in addition to antitrust regulation state authorities must facilitate to the forming of effective competition in numerous fields of economy.

It is important to mention that one cannot remove monopolies in artificial ways, it is necessary to aid the competitors of monopolists. One of such ways in RA is the assistance to fulfillment of small and medium business. Great work is being done currently in this direction in Armenia. During last years the assistance to small and medium business got somewhat systematic approach and being simultaneously included in The Strategic Plan of Poverty Overcoming, got its own place within social and economic policies of the government. The volume of state investments in this field is still far from being sufficient though.

Formal barriers to entry to the markets have been reduced. For example, the cost of registering a business is now negligible and occurs with few delays. The Armenian authorities are determined to eliminate delays altogether; however, reducing the costs of formalization does not address the many issues related to the benefits of being formal. Public goods related to the business sector are still inadequate. The main reasons for formality are access to finance and access to a system of formal

contracting. In Armenia, financial markets function poorly and the system of contracting and dispute resolution is haphazard at best so that even under normal circumstances it is not effective. Armenian businesses have little incentive to formalize and the current system also allows petty officialdom to target formal businesses with inspections that have payoffs as their aim.

The new descriptors, established through fundamental changes in the economy of Armenia in the last decade and obligations, undertaken with the aim to integrate to international devices have called for the necessity of antitrust policy. The first step of making a reality of this is the passing of the antitrust law. The existence of the latter, along with an effective legal system and competition regulating agendas, promote the effectiveness, development and stability of defending entrepreneurs and consumers.

During last years, great work has been done in RA to form and improve the legislative foundation of antitrust regulation and to increase the effectiveness of management system. Particularly, Law on Protection of Economic Competition was adopted in 2000 and State Commission of Protection of Economic Competition was formed in 2001. But still there are a lot of drawbacks and obstacles and only after overcoming them, RA could become a state implementing an effective antitrust policy.

Armenian economy actually characterizes with high level of monopolization. Currently there are a number of appearances of unfair competition in the economy of Armenia like unregulated over occupying, discriminatingly pricing, abuse of a dominant position, shadow activities, inequality between local and importing companies, anti-competitive agreements and concentrations. This is the reason that the realization of antitrust policy is a crucial point now.

Keeping the current economic reality in mind, concerning to some problems of transition period, it is necessary to create conditions for formation of effective competitive environment. Successful reforms are only possible through purposeful and effective antitrust policy, although such approach is completely absent now. The effective antitrust regulation and the realization of a purposeful antitrust policy are extremely urgent problems for RA.

The question about which markets create the best conditions for business development, for the defense of consumers' rights and, eventually, for formation of effective competitive environment, gets its answer during the investigation of a number of product markets of the Republic (Table 1) (Official review of State Commission of Protection of Economic Competition of the Republic of Armenia N:3 (7), 2004).

**Table 1: Concentration levels of different markets of RA in 2001-2004 period presented by CR-3 coefficient**

Title of the market	2001	2002	2003	2004
Alcohol-spirit	95.2	90.7	90.2	95.8
Wine	95.3	89.4	95.2	97.6
Beer	99.7	95.9	94.5	100.0
Sugar	98.0	100.0	95.90	100.0
Coffee	45.4	---	56.2	---
Solt	100.0	100.0	100.0	100.0
Wheat flour	80.7	65.5	---	72.2
Food flour	67.4	43.4	56.1	71.0
Petrol	58.1	58.8	66.9	79.9
Diesel fuel	54.2	69.9	75.7	72.4
Cement	100.0	100.0	100.0	100.0
Plaster	100.0	100.0	100.0	100.0
Kerosene	100.0	100.0	100.0	100.0
Filter-tipped cigarette	81.7	81.7	90.8	92.6
Unfiltered cigarette	97.4	99.9	99.5	99.0
Nitrogenous fertilizers	---	96.1	80.6	---
Ice-cream	85.2	80.9	---	85.6
Animal oil	61.8	---	66.2	65.6
Vegetable oil	59.2	---	51.7	51.3

CR-3 coefficient is the sum of the parts of three largest economic subjects in the gross sales for the market. The market is of high concentration if  $70\% < CR-3 < 100\%$  and of medium if  $45\% < CR-3 < 70\%$

Today competition development level obviously is not sufficient in Armenia. After performing comprehensive investigation we can determine several reasons of the latter:

- Privatization process did not give birth to emerging of effective owners, who would be full of care about the development and prosperity of their companies.
- Small and medium entrepreneurship didn't get wide development.
- Enterprise compulsory restructuring was not used, though it could lead to emerging of effective entrepreneurs.

In RA the problems of antitrust regulation realization are mainly conditioned on the drawbacks of antitrust legislation, the absence of antitrust policy and strategy and factors hindering antitrust authorities from efficient activity. Actually, the main directions of antitrust regulation should be the improvement of antitrust legislation and the activities of state plenipotentiary authorities in the appropriate field, development and realization of purposeful antitrust policy and strategy.

It is worth to mention that despite the RA Law on Protection of Economic Competition serves as a basis for antitrust policy, the realization of policy includes the working and utilization of much wider set of measures, which should conform to the priorities of the policy. The priorities should be defined according to existing and possible problems-classified upon their importance. Afterwards, the problems defined must be confronted with resolution possibilities and, if the problem is of primary importance and there are possibilities of its resolution, the problem is then chosen as a priority. The next step is the working and utilization of concrete measures directed to that problem's resolution. The realization of these steps is of vital importance for effectiveness of antitrust regulation policy.

In transitional economies an effective antitrust policy assumes the following measures to be implemented:

- Smashing very large companies into smaller ones and wide spread occurrence of small and medium business units,
- Formation of competing productions (companies, as well as private entrepreneurs),
- Organization of consumer unions which promote to competition development and formation of antitrust legislation.

The different programs of counter-monopolization are an integral part of antitrust policy. In our opinion counter-monopolization, along with privatization, should have been on the base of reorganization of centralized economy during early-to-mid 90-s. The neglecting of this policy was one of the reasons for inferior results of economic reforms in Armenia.

It's now the time to mention that the term counter-monopolization doesn't mean a simple breaking of monopolistic companies. In its contemporary meaning, counter-monopolization includes a wide set of measures directed to the development of competition in artificially monopolized fields of economy. These measures should by all means be checked against the don't harm principle.

We think that such measures in Armenia could be the following:

- The softening of administrative and economic obstacles for entering the market,
- The assistance to formation of competitive institutes and business units, import of products into monopolistic fields, as well as promotion of the SME development,
- The assistance to formation of markets of new products and services,
- The formation and development of information and distribution infrastructure,
- Promotion of national production and protection of internal markets particularly in the fields where importing monopolies are formed,
- The aid to business units directed to improve their competitiveness in regional and worldwide markets.

Currently it is necessary to work and utilize a conception of antitrust policy, which main directions, in our opinion, should be the following:

- Improvement of the legislative basis and antitrust regulation methods – aiming to prevent the abuse of leading position, anti-competitive agreements, unfair competition which result in limited competition and hit at the interests of citizens and business units.
- Creation of conditions for competition development in highly centralized fields of economy, removal of obstacles for other business unit entering the market.
- Strengthening the control in artificially monopolized markets as well as spreading of antitrust requirements in financial markets, including banking and insurance fields.
- Establishment of multi-directional and continuous relations with regional autonomous bodies aiming the increase of popularity of works of antitrust regulation body and efficiency of antitrust policy in districts.
- Putting in antitrust requirements in the field of public procurement and public aid.
- Conformity among counter-monopolization and competition development objectives, problems and measures in product markets, adaptation of RA antitrust policy for integration with world economic society.

### **CONCLUSIONS**

In RA market economy is already established at some level as far as there are free economic subjects and state regulation model adapted to market relations is chosen. Hence it can be determined that competitive environment exists in RA. Although numerous fields of Armenian economy are either monopolized or have high level of concentration. That's why the development and realization of effective antitrust policy is an urgent problem in RA. For that purpose first of all it is important to develop concept of antitrust policy mentioning the main directions of its implementation.

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