UMT School of Law and Policy

Entry Test

For

LL.M. in Commercial Law Program

**Part-I**

1. **Instructions**
2. The applicant has 45 minutes to attempt this part.
3. The applicant must write all the answers on the given sheets in the given spaces.
4. **To be filled by the applicant**

|  |  |
| --- | --- |
| **Name** |  |
| **Date** |  |

1. **To be filled by the School**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Marks** | **Q 1** | **Q 2** | **Q 3** | **Q 4** | **Q 5** |
| **/5** | **/5** | **/5** | **/5** | **/5** |
| **Comments** |  | | | | |

Read the passage and attempt the questions that follow

Competition means a struggle or contention for superiority, and in the commercial world this means a striving for the custom and business of people in the market place: competition has been described as ‘a process of rivalry between firms . . . seeking to win customers’ business over time’. The ideological struggle between capitalism and communism was a dominant feature of the twentieth century. Many countries had the greatest suspicion of competitive markets and saw, instead, benefits in state planning and management of the economy. However enormous changes took place as the millennium approached, leading to widespread demonopolization, liberalization and privatization. These phenomena, coupled with rapid technological changes and the opening up of international trade, unleashed unprecedentedly powerful economic forces. These changes impact upon individuals and societies in different ways, and sometimes the effects can be uncomfortable. Underlying them, however, is a growing consensus that, on the whole, markets deliver better outcomes than state planning; and central to the idea of a market is the process of competition.

The important issue therefore is to determine the effect which competition can have on economic performance. To understand this one must first turn to economic theory and consider what would happen in conditions of perfect competition and compare the outcome with what happens under monopoly, recognizing as one does so that a theoretical analysis of perfect competition does not adequately explain business behavior in the ‘real’ world.

At its simplest – and it is sensible in considering competition law and policy not to lose sight of the simple propositions – the benefits of competition are lower prices, better products, wider choice and greater efficiency than would be obtained under conditions of monopoly. According to neo-classical economic theory, social welfare is maximized in conditions of perfect competition. For this purpose ‘social welfare’ is not a vague generalized concept, but instead has a more specific meaning: that allocative and productive efficiency will be achieved; the combined effect of allocative and productive efficiency is that society’s wealth overall is maximized. Consumer welfare, which is specifically concerned with gains to consumers as opposed to society at large, is also maximized in perfect competition. A related benefit of competition is that it may have the dynamic effect of stimulating innovation as competitors strive to produce new and better products for consumers: this is a particularly important feature of high technology markets.

The theoretical model just outlined suggests that in perfect competition any producer will be able to sell his product only at the market price. The producer is a price-taker, with no capacity to affect the price by his own unilateral action. The consumer is sovereign. The reason why the producer cannot affect the price is that any change in his own individual output will have only a negligible eff ect on the aggregate output of the market as a whole, and it is aggregate output that determines price through the ‘law’ of supply and demand.

Under conditions of monopoly the position is very different. The monopolist is in a position to affect the market price. Since he is responsible for all the output, and since it is aggregate output that determines price through the relationship of supply to demand, he will be able either to increase price by reducing the volume of his own production or to reduce sales by increasing price: the latter occurs in the case of highly branded products which are sold at a high price, such as luxury perfumes. Furthermore, again assuming a motive to maximize profits, the monopolist will see that he will be able to earn the largest profit if he refrains from expanding his production to the level that would be attained under perfect competition. The result will be that output is lower than would be the case under perfect competition and that therefore consumers will be deprived of goods and services that they would have been prepared to pay for at the competitive market price.

There is therefore allocative inefficiency in this situation: society’s resources are not distributed in the most efficient way possible. The inefficiency is accentuated by the fact that consumers, deprived of the monopolized product they would have bought, will spend their money on products which they wanted less. The economy to this extent is performing below its potential. The extent of this allocative inefficiency is sometimes referred to as the ‘deadweight loss’ attributable to monopoly. The objection to monopoly does not stop there. There is also the problem that productive efficiency may be lower because the monopolist is not constrained by competitive forces to reduce costs to the lowest possible level. Instead the firm becomes ‘X-inefficient’. This term, first used by Liebenstein, refers to a situation in which resources are used to make the right product, but less productively than they might be: management spends too much time on the golf course, outdated industrial processes are maintained and a general slackness pervades the organization of the fi rm. Furthermore the monopolist may not feel the need to innovate, because he does not experience the constant pressure to go on attracting custom by offering better, more advanced, products. Thus it has been said that the greatest benefit of being a monopolist is the quiet life he is able to enjoy. However it is important to bear in mind that inefficient managers of a business may be affected by pressures other than those of competition. In particular their position may be undermined by uninvited takeover bids on stock exchanges from investors who consider that more efficient use could be made of the firm’s assets. Competition may be felt in capital as well as product markets: this is sometimes referred to as ‘the market for corporate control’.

A final objection to the monopolist is that, since he can charge a higher price than in conditions of competition (he is a price-maker), wealth is transferred from the hapless consumer to him. This may be particularly true where he is able to discriminate between customers, charging some more than others: however it is important to recognize that price discrimination in some circumstances may be welfare-enhancing, or at least neutral in terms of social welfare, in particular where it allows firms to recover fixed expenditure that would otherwise not have been recovered. While it is not the function of competition authorities themselves to determine how society’s wealth should be distributed, it is manifestly a legitimate matter for Governments to take an interest in economic equity, and it may be that one of the ways in which policy is expressed on this issue is through competition law.

Thus runs the theory of perfect competition and monopoly. It indicates that there is much to be said for the ‘invisible hand’ of competition which magically and surreptitiously orders society’s resources in an optimal way, as opposed to the lumbering inefficiency of monopoly. However, we must now turn from the models used in the economist’s laboratory to the more haphazard ways of commercial life before rendering a final verdict on the desirability of competition.

**Question I**

Briefly discuss the following terms:

1. Capitalism
2. Communism

In your opinion, a competitive market would form part of which of the aforementioned systems and why?

**Question II**

Having read the passage, in your opinion, what would the study of competition law entail?

**Question III**

In Paragraph 4, the author uses the term ‘theoretical model’ to describe the model of perfect competition. Why, in your opinion, does he use this particular expression?

**Question IV**

Liebenstein first used the term X-inefficient. What does this expression mean?

**Question V**

What is a monopolistic market structure? What are the disadvantages of the same?