

PREVENTING CARTELS: THE EFFECTIVENESS OF LENIENCY POLICY

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Abstract. This paper focuses on the theory and practice of antitrust action in detecting and deterring cartels, and analyzing the development of the modern leniency policy. Following the examination of the main conditions and reasons for cartel formation and sustainability, and a statistical analysis of cartel prosecutions, our attempt is to show that leniency programs, accompanied by strong enforcement powers and effective sanctions, increase the inherent instability of cartels and therefore have proven to represent a functional and successful tool for detecting and punishing, as well as preventing the formation of anticompetitive agreements.

Keywords: cartel, leniency, competition policy, antitrust law, imperfect competition, oligopoly.

Jel: K21, L13.

1. Introduction

Competition is a crucial factor for the creation of proper conditions for economic growth and prosperity. The role of modern competition policy is to ensure that competition is indeed effective. Secret cartel agreements are a direct assault on the principles of competition and are universally recognized as the most harmful of all types of anticompetitive conduct. Facing the challenges associated with globalization of market economy, competition authorities around the world are increasing their efforts to design and implement modern instruments, effective enforcement procedures and adequate sanctions against cartels. Using meta-analysis of economic and legal literature, cartel case studies, and descriptive statistical analysis, the aim of the paper is to show that leniency programs and strong enforcement powers, along with effective sanctions increase the instability of cartels, which helps prevent anticompetitive agreements.

2. The economics of cartels

A cartel is essentially an arrangement between competing firms designed to limit or

eliminate competition between them, with the objective of increasing prices and profits of the participating companies. In practice, this is generally done by fixing prices, limiting output, sharing markets, allocating customers or territories, bid rigging or a combination of these specific types of restriction. Collusive behavior does not always rely on the existence of explicit agreements between firms: coordination of firms' competitive behavior can also result from situations where firms act individually but – in recognition of their interdependence with competitors – jointly exercise market power with the other colluding competitors. This is normally described as “tacit collusion”.

The theory of "cooperative" oligopoly provides the basis for analyzing the formation and the economic effects of cartels. Oligopolistic firms join a cartel to increase their market power, and members work together to determine jointly the level of output that each member will produce and/or the price that each member will charge. By working together, the cartel members are able to behave like a monopoly by restricting industry output, raising or fixing prices in order to earn higher profits. As long as the firms adhere to the implied agreement or understanding they can profitably raise their prices above current levels and earn greater profits. This harms their consumers who now pay more and consume less, because in order to raise prices the cartel members must restrict output. The effects of a cartel are thus comparable to those of a monopolistic market: redistribution of surplus from consumers to producers as well as a welfare loss due to a too small quantity supplied (deadweight loss). Competition law aims at prohibiting such restrictive practices in order to eliminate sources of inefficiencies (Posner 1998).

The damage caused by cartels to the economy and consumer welfare is substantial. A good indication of the direct and immediate social harm caused by cartel activity is its effect on prices. In 2008 the Commission of the European Communities made some general estimates of the harm to the economy caused by cartels. The Commission services looked at the 18 cartels which were the subject of Commission decisions during the years 2005 to 2007, the size of the markets involved, the cartels' duration and the very conservative assumptions regarding the estimated overcharge. Assuming an overcharge of between 5–15 percent, the harm suffered ranges from around EUR4 billion to EUR11 billion for these 18 cartels. Taking the middle point of this overcharge range – 10 percent – gives a conservative estimate of consumer harm of EUR 7,6 billion due to these cartels. Even this figure is probably too low: economic literature on the subject suggests that the average overcharge in prices can be as high as 20–25 percent (Report on Competition Policy 2009).

Nevertheless, cartels have been defended from time to time. As C. Veljanovski (2006) points out, price and market sharing arrangements were until recently seen as the usual way of doing business; others have claimed that price-fixing is sometimes necessary to prevent “ruinous” or “destructive” competition in oligopolistic industries with high fixed costs subject to frequent “price wars” and that there may be social

gains from price-fixing agreements.

Some authors state that cartels rather play a positive role in meeting some specific demands of the market (Salin 1996). Others, criticizing government intervention against cartels, argue that cartels are inherently unstable and short-lived, and therefore not a real problem (Moran, Novak 2009). Indeed, Game theory suggests that cartels are inherently unstable, as the behavior of members of a cartel is an example of a Prisoner's dilemma. Each member of a cartel faces a conflict of interests when agreeing to increase its prices: by producing more output than it has agreed to produce, a cartel member can increase its share of the cartel's profits. Hence, there is a built-in incentive for each cartel member to cheat. Furthermore, the incentive and possibility of cheating, together with lack of an effective mechanism for monitoring and disciplining, results (or so it is argued) in an atmosphere of mistrust among cartel members, which makes cartels difficult to maintain, once established.

However, in our opinion, only knowing the theoretical possibilities for cartel members to cheat is insufficient to conclude that all or many of them are unstable and short-lived. Evidence supporting our view that colluding firms are able to overcome problems causing the instability can be collected from the cartels prosecuted by competition authorities. Statistical data on the longevity of more than 230 private international cartels discovered anywhere in the world from January 1990 to the end of 2005 shows that one cartel that persisted through two world wars and multiple changes in competition laws endured for 95 years. Median duration of cartels during indicated period was 5,0 years and mean duration 6,4 years. The longest lasting cartels were the global (6,0 median years) and EU-wide (5,5) types (Connor, Helmers 2006).

Yet, the theory of cartel instability can be very useful, first, for identifying industries more or less susceptible to effective formation and maintaining of a cartel and, second, for devise of means and instruments that increase the instability of cartels and facilitate their detection.

3. Legislation and leniency policy

Secret cartels are the most serious violation of competition rules since they invariably result in higher prices. Many competition authorities in all parts of the world attach great importance to the detection of cartels. Without exception, the legal systems of the member states of the European Communities include rules prohibiting collusive agreements between competitors. The detection, prohibition and punishment of cartels is one of the highest priorities of the European Commission in the field of competition policy.

Considering the harmful effects of cartels on society and on consumers in particular, it is also generally accepted that the rules prohibiting cartels should be accompanied by effective enforcement powers and sanctions. In this sense, one of the most sig-

nificant contributions of recent years to the global fight against cartels is leniency policy, designed as to encourage a cartel member to confess and implicate its co-conspirators with direct evidence about their illegal activity. Leniency could mean any reduction in the penalty compared to what would be otherwise imposed if the cartel was detected: smaller fine, shorter sentence, less restrictive order, or complete amnesty. Leniency programs are based on particular conditions which must be achieved and respected in order to qualify for such treatment.

The experiences of the United States and the European Commission have shown that a properly structured leniency program can dramatically increase the success of a fight against cartels. The first country to introduce a leniency program was the United States in 1978, but there was not an immediate success. In 1993 the US Department of Justice made some important changes, which had a substantial impact on the program: the rate of applications jumped to approximately one per month comparing to only one on average application per year under the 1978 leniency program. Leniency applications were directly responsible for success in several high profile prosecutions by the Justice Department, including conspiracies in vitamins, graphite electrodes, marine construction and fine art auctions.

The European Commission first introduced its leniency program in 1996 and revised it twice, in February 2002 and in December 2006. The principal change, comparing the 2002 revision to the original version, was to promise full (100 percent) immunity from fines to the first corporation to provide evidence before the Commission has begun an investigation. The improvements in the 2006 revision reflected the experience acquired in implementing previous versions and were set out to create even greater transparency and legal certainty (Hard Core... 2003).

Under the 1996 Leniency Notice the Commission received 188 applications for non-imposition or reduction of fines. Under the 2002 and the 2006 Notices the Commission received 157 applications for immunity and 146 applications for reduction of fines, granting conditional immunity on 58 applications, from entry into force of the Notice on 14 February 2002 until the end of 2008. In the period from 2002 to the end of 2008, the Commission adopted statements of objections in 52 cartel investigations. 46 of these investigations started on the basis of information received under the 1996, 2002 or 2006 Leniency Notice.¹ These numbers prove that leniency policy has been extremely effective making detection of cartels more probable and prosecution more frequent. However, the ultimate purpose of using leniency to fight cartels is to deter every company from continuing or engaging in such behavior. N. H. Miller (2009) provides evidence that leniency programs might have positive effects in this respect. His study of US cartels between 1985 and 2005 shows that the number of cartel discoveries significantly increased around the date of the introduction of 1993 corporate

¹ See: European Parliament. Parliamentary questions. Joint answer given by Ms Kroes on behalf of the Commission. Written questions: E-0890/09, E-0891/09, E-0892/09. 2 April 2009

leniency program and then sharply dropped. Such a pattern is consistent with intensified cartel detection and improved deterrence. The success of the US and EC programs has stimulated other countries to adopt national leniency programs as an effective instrument to counter cartels. Lithuanian Competition Council, integrating the guidelines of EC Leniency Notice, introduced its leniency program in 2008.

The data presented in table 1 and figure 1 shows that after implementing of Leniency Notices by European Commission (since 1998) the fight against cartels has become more efficient: the number of decisions in cartel cases increased three times. 75 percent of cartels since 1990 were detected, prosecuted and fined in the period of 2000–2009.

Table 1. Cartel cases decided by the European Commission since 1990 (Source: www.europa.eu.int/competition/cartels/statistics)

Period	Number of cartels	Total, %
1990–1994	11	13,1
1995–1999	10	11,9
2000–2004	30	35,7
2005–2009	33	39,3
Total	84	100

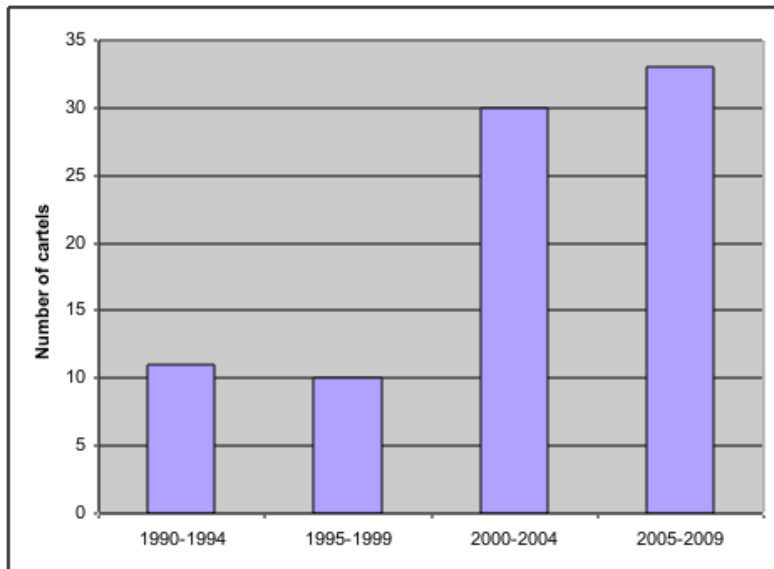


Fig. 1. Dynamics of cartel cases decided by the European Commission since 1990 (Source: created by the author using data from www.europa.eu.int/competition/cartels/statistics)

There is a very important aspect to a successful leniency program: there must be a credible threat of severe sanctions for participating in a cartel. Unless cartel operators are at risk for substantial punishment if their agreement is discovered and prosecuted, they will have little or no incentive to enter leniency program. (Hard Core ... 2003) The statistical analysis of fines imposed by European Commission on companies that infringe EC Treaty rules, leads to the conclusion that the success of leniency policy by increasing the number of prosecuted cartels is based on the synergy created by the joint application of the Guidelines on the method of setting fines, adopted by the Commission in 1998 in order to enhance transparency as to its fining policy, and the Leniency Notice. Comparing to the period of 1995–1999, the total amount of fines imposed on the companies in cartel cases increased 12 times (Table 2 and Fig. 2).

Table 2. Fines imposed by European Commission in cartel cases 1990–2009 (Source: www.europa.eu.int/competition/cartels/statistics)

Period	Amount in €
1990–1994	344.282.550
1995–1999	270.963.500
2000–2004	3.173.585.210
2005–2009	9.753.714.300
Total	13.542.545.560

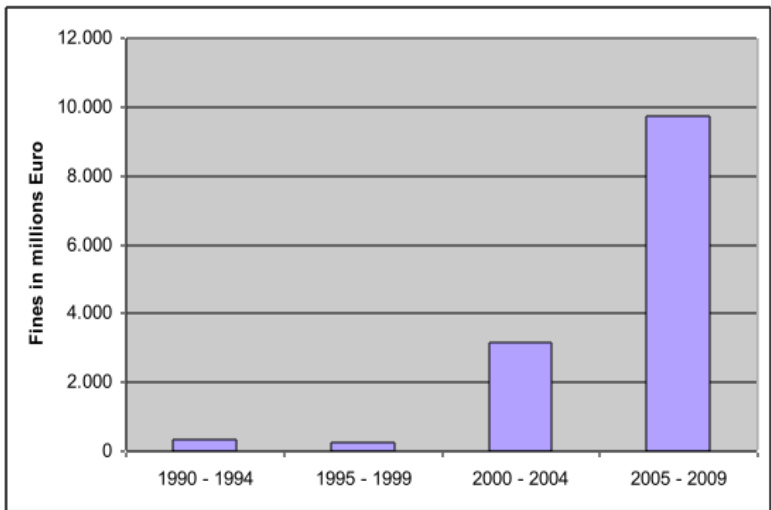


Fig. 2. Dynamics of fines imposed by European Commission in cartel cases 1990–2009 (Source: created by the author using data from www.europa.eu.int/competition/cartels/statistics)

The synergies derived from the combination of a preventive and deterrent approach were further strengthened by the adoption in 2006 of the new Guidelines on the method of setting fines. The revised Guidelines included three main changes: the new entry fee, the link between the fine and the duration of the infringement, and the increase for repeat offenders. The implementation of these new Guidelines not only increased the total amount of fines imposed by the Commission with respect to cartel infringements in recent years compared to the previous periods, but also resulted in a number of record fines imposed in separate cartel cases, including fines amounting to a total of EUR1.384 billion on four companies in the Car glass cartel in 2008 and fines amounting to EUR992 million imposed on four companies in the Elevators cartel in 2007². It is expected that these large fines will increase the attractiveness of the leniency program and lead to detection of even greater number of cartels.

4. Conclusions

A cartel is essentially an agreement between firms to limit output with the aim of raising prices and profitability. In practice, this is generally done by means of price fixing, allocation of production quotas or sharing of geographic or product markets. Among the anti-competitive practices sanctioned by the competition law, cartel is the most harmful to the competitive environment and often very difficult to detect. Therefore, the fight against cartels is central to ensuring that the benefits of a properly functioning competition regime are offered to the final consumer in a given market for products or services. The ultimate purpose of prohibiting such anti-competitive behavior and fining cartel members is not only to punish the companies involved for past behavior, but above all to deter every company from continuing or engaging in anti-competitive behavior. Strong cartel enforcement ensures that cartels that may otherwise be formed are discouraged.

The most important contribution in recent years to the global fight against cartel formation and sustainability derives from the adoption of leniency programs. A strategy of amnesty and immunity improves the collusion detection by destabilizing existing cartels through the construction of an environment of distrust and tension. Statistical analysis shows that it has led to a substantial increase in the number of cartels that have been uncovered and punished.

However, to be effective, leniency programs must be backed up by strong enforcement powers and effective sanctions. To have a real deterrent effect fines must be sufficiently large to eliminate the gains from the cartel and, in addition, impose a signifi-

² See: Summary of Commission Decision of 12 November 2008 relating to a proceeding under Article 81 of the Treaty establishing the European Community and Article 53 of the EEA Agreement (Case COMP/39.125 – Car glass). OJ C 173, 25.7.2009, p. 13–16

cant punishment on the individual undertaking. The level of fines imposed by the European Commission with respect to cartel infringements has increased considerably over the past decade. In recent years, the Commission has imposed a number of record fines for cartel infringements. It is expected that these large fines will increase the attractiveness of the leniency program and lead to detection of even greater number of cartels.

In conclusion, leniency programs together with adequate fining policies have two major effects on cartels: in the short run they facilitate the detection of cartels and thereby reduce costs of legal enforcement, and in the long run they deter firms from antitrust abuse by discouraging them from continuing or entering into anticompetitive collusion.

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KARTELINIŲ SUSITARIMŲ PREVENCIJA: AMNESTIJOS PROGRAMŲ VEIKSMINGUMAS

D. Klimašauskienė

Santrauka

Plėtojant šiuolaikinę ekonomiką ypatingas dėmesys teiktinas sąžiningai rinkos dalyvių konkurencijai, kuri skatina inovacijas, efektyvumą bei pasirinkimo laisvę. Reaguojant į šiuolaikinius iššūkius, susijusius su globalizacijos procesais ekonomikoje, kurie skatina tarptautinių ir netgi globalių kartelių formavimąsi, modernios konkurencijos politikos prioritetu tampa kova su draudžiamais susitarimais tarp konkurentų (karteliais) kaip vienu pavojingiausių konkurencijos teisės pažeidimų, o ypač jų prevencija. Kartelio pavojus ne tik tas, kad jo pasekmės yra itin skaudžios ekonomikai ir vartotojams, bet ir ypač slaptas tokių susitarimų pobūdis, dėl kurio konkurencijos priežiūros institucijos susiduria su dideliais sunkumais išaiškinant kartelius. Straipsnyje, analizuojant ekonomines kartelių formavimosi ir stabilumo prielaidas bei teisinio reguliavimo pagrindus, nagrinėjami kovos su karteliais būdai, kurie padeda sumažinti ekonomines paskatas sudaryti kartelį, atgrasinti ūkio subjektus nuo galimų pažeidimų, paskatinti jau sudaryto kartelio narius pranešti apie pažeidimą ir, bendradarbiaujant su tyrėjais, padėti jį kuo greičiau išaiškinti, taip sumažinant visuomenės patiriamą žalą. Ypatingas dėmesys skiriamas atleidimo nuo baudų ir baudų sumažinimo (amnestijos) programoms, kurios, sukurdamos netikrumo ir nepasitikėjimo atmosferą tarp susitarimo dalyvių, tampa naudinga priemone, leidžiančia intensyviau ir griežčiau kovoti su karteliais. Šias programas, susietas su baudžiamųjų sankcijų sugriežtinimu ir baudų padidinimu, galima laikyti reikšmingiausiu pastarojo dešimtmečio indėliu į globalią kovą su karteliais, kurio dėka labai padidėjo kartelių išaiškinimo mastas, o baudos, paskirtos įmonėms už draudžiamus susitarimus, pasiekė rekordines aukštumas.

Reikšminiai žodžiai: konkurencija, karteliai, susitarimai tarp konkurentų, konkurencijos politika, amnestijos programos.

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