



Private International Cartels – An Overview

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Cartels are considered to be, ‘the most egregious violations of competition law’. Cartel operations raise prices, restrict supply, inhibit innovation, and result in artificially concentrated markets, waste, and inefficiency. They are therefore condemned in competition laws around the world. Currently, there are countries whose national competition authorities recognise cartels as a top enforcement priority.

However in many countries, the legal and regulatory response to cartel activity is very inadequate and there thus exists an urgent need to create more awareness regarding the devastating effects of cartels. Efforts are being made to formulate a coherent international approach with respect to cartel enforcement. This briefing paper is a concise overview of the definitional aspect of international cartels (a particular type of cartel), the harm they cause, the existing legal and regulatory framework, and options for reform.

Introduction

“People of the same trade seldom gather together, whether for merriment or diversion, but the conversation ends in a conspiracy against the public or some contrivance to raise prices” – Adam Smith

What is a cartel? To paraphrase a definition provided by the Organisation for Economic Co-operation and Development (OECD), a cartel is an agreement, practice, or arrangement by competitors to collude and fix prices, rig bids, allocate quotas, or divide markets. The cornerstone of such cartels is joint profit maximisation. Cartels are widely considered the most harmful anti-competitive conduct prevalent in markets today, and are prohibited by law in most countries. Certain countries allow in their law, exceptions to what is traditionally considered a cartel and such agreements or practices will obviously be exempt from legal sanctions. An example of a very well known cartel would be the Organisation of the Petroleum Exporting Countries (OPEC), which engages in fixing the price of oil supplied by OPEC countries. OPEC is a sovereign cartel, and as such immune from law.

This paper is confined to examining one particular type of cartels, namely, private international cartels (hereafter referred to as ‘international cartels’), which are basically express tacit cartel agreements among private producers from multiple countries, resulting in the restriction or suppression of fair competition. All other types of

cartels such as import cartels, export cartels, domestic cartels, and sovereign cartels such as OPEC are beyond the scope of this paper.

A Post-Liberalisation Reality?

Although it was only very recently that the extent of harm caused by international cartels has been documented, international cartels are by no means a recent phenomenon or a by-product of liberalisation, as its cross border dimensions would seem to suggest. International private cartels are at least 125 years old. However, there was a lull in their formation after the 1940s-1950s. The 1990s again saw a global resurgence in international cartels (Connor, 2003).

Liberalisation, however, may indeed have facilitated the success of cartels owing to markets opening up across the world, making it possible to engage in transnational anti-competitive practices on a much larger scale than before, and garner larger profits thereby. International cartels today definitely undermine international integration and decrease the benefits of liberalisation to consumers.

Cartel Sustainability

The detrimental repercussions of international cartels are compounded by their wide prevalence and durability, sustained existence, and the secrecy with which they conduct their operations.

Prevalence and Durability

There is widespread prevalence of international cartels. Since 1990, US and EU authorities have prosecuted about 100 international cartels (Connor, 2003). This considered in conjunction with the fact that some believe that as few as one in six or seven cartels are detected and prosecuted (OECD, 2002), and also that other cartels may have been discovered and prosecuted in countries other than the US and EU, gives a rough indication of their high incidence. The average duration of cartels in the 1990s is six years, with some lasting for twenty years before intervention by competition authorities.

In view of the pernicious anti-competitive effects of cartels, it is disturbing that they can continue undetected so long, considering they operated in countries such as the US and EU, which have well-equipped competition agencies. Their durability in most developing countries would in all likelihood be far greater, considering the absence of an effective competition regime, if at all.

Sustained Existence

International cartels can only have a sustained existence if there is successful collusion. But cartel members have considerable incentive to cheat by selling below the cartelised price, increasing their output and market share and thereby increasing profits. Therefore, colluding firms have to take measures to deter cartel members from cheating. Given the success of cartels, their general ability to overcome individual member inducement to cheat is apparent.

Secrecy

The secrecy with which international cartels conduct their operations renders it very difficult to discover and prove their existence. Cartel operators can go to great lengths to keep their agreements secret, and in doing so reveal that they know only too well that the conduct in question is harmful and illegal. A telling example would be, when in the investigation of the fire protection devices cartel in Australia, pursuant to a demand for certain incriminating documents, conspirators took the files concerned into the country where it took them a full day to burn them in four huge bonfires. (OECD, 2003)

An Effects Evaluation

An Overview

The damage inflicted by international cartels on the world economy is very substantial, although it is difficult to quantify accurately.

A conservative estimate of the harm caused by cartels exceeds billions of dollars per year. In fact, statistical data reveal that successfully prosecuted international cartels have affected markets with more than US\$200bn

Box 1: An Illustrative Case Study: The Vitamins Cartel

Duration and Effect: The vitamins cartel to fix prices and allocate market shares for the sale of certain vitamins operated from 1990-1999. Annual global sales over the conspiracy period averaged US\$1.34bn. (Yu, 2003) The price increase generated by this cartel has been estimated to be 35 percent. In the US alone this cartel may have produced US\$500mn in overcharges. (OECD, 2003)

Impact on Developing Countries: The aforementioned high overcharge definitely impacted developing countries in view of the fact that developing countries imported around US\$6.6bn worth of vitamins in the course of the conspiracy. (Yu, 2003)

Sanctions: US, Canada, EC, Australia, and South Korea have each investigated and prosecuted the cartel for its effect on their domestic markets. The US and Canadian authorities have fined the cartel approximately US\$1bn and the EC •85mn, respectively. (OECD, 2000) The Korea Fair Trade Commission (KFTC) imposed corrective measures and a civil penalty to the amount of 3.9 billion Korean *Won*. Brazil, Japan and Mexico are reported to be investigating.

in sales. The simple average overcharge was about 30 percent of affected sales (Connor, 2003). To consider these statistics in the light of the many other undiscovered and unproven cartels likely to be in existence is to realise the extent to which international cartels are a drain on the world economy.

The harm consequent to cartel activity comprises the following:

- Goods and services are rendered needlessly expensive for some consumers and completely unavailable to others who refuse to buy at the heightened cartelised price;
- Decreased product choice;
- Cartel members, screened from the full impact of market forces may experience less impetus to control costs and innovate; and
- The prices of products bought by cartels necessarily decrease as a result of collusion affecting both small and large businesses. These victims have included some of the biggest names in business, for instance, Coca-Cola, Procter & Gamble, Tyson Foods, Kellogg, and Nestle. Small sellers may even be squeezed out of the market altogether.

Although harm is caused to both developed and developing countries by international cartels, developing countries are especially vulnerable to such collusion.

The Impact on Developing Countries

Most developing countries do not have a strong enough legal and regulatory framework for competition law enforcement, and therefore lack the capability of detecting and dealing with international cartels. As such, the activities of cartels that negatively impact the economy of developing markets often continue unabated.

Current trade data reveals that the amount of imports by developing countries from a sub-sample of 19 industries that experienced collusion during the 1990s stood at US\$54.7bn. That represents 5.2 percent of developing countries' total imports and 1.2 percent of their total Gross Domestic Product (GDP). Price increase ranged from 10 percent, in the case of thermal fax paper cartel, to 100 percent, in the case of stainless steel cartel (Yu, 2003).

Apart from the detriment to consumers in developing countries, their businesses are also adversely affected. Firstly, they are often compelled to buy overpriced inputs as a result of existing cartels selling at a heightened price. Secondly, in order to ensure cartel survival, cartel members resort to a range of measures to bar rival producers in developing countries from exporting to the markets of the cartel members. These measures involve the usage of government authorised trade barriers, for instance, high tariff and also the utilisation of private barriers such as the threat of retaliatory or predatory price wars.

Positive benefits may accrue to developing country businesses to some extent, for instance, they may benefit from selling at the price set by the cartel or at a slightly less price, not having to adhere to the cartel production quota. But such benefit is of little value, as these producers can only be fringe players given the usual strength of cartels in international markets.

A future concern might be that, in light of stringent action being taken against international cartels in the developed world, such cartels may begin to focus more on developing country markets where regulations are far more lax.

The Legal and Regulatory Framework

National Laws

At the start of the 1990s, only the US was taking cogent action against international cartels. However, by the end of the decade, with increasing awareness about the harmful effects of international cartels, other countries became convinced that stronger measures against international cartels ought to be taken.

There is a general agreement amongst countries around the world that international cartels are punishable under their laws. In certain jurisdictions cartels are illegal *per*

Box 2: International Cartels – India's Approach to Legal Enforcement

Till date, almost nothing has been done on international cartels, in India. However, it is not as though India has remained untouched by international cartels. A study done by Simon Evenett and Julian L. Clarke estimates that the overcharges in India during the conspiracy period of the vitamins cartel were US\$25.71mn. There may have been other cartels that negatively impacted India. There may be many such cartels in the future as well. What then is India's legal and institutional capacity to deal with international cartels?

CUTS, an India-based public interest organisation collected some information on the vitamins cartel and passed it on the competition authorities for further action. However, the competition authorities came to the conclusion that no case could be made in this regard. The grounds for arriving at such a conclusion was, however, not known. Many of the companies involved in this case have commercial presence in India and the issue of jurisdiction, in all probability, would not have been a hindrance.

The old competition law of India (Monopolies and Restrictive Trade Practices Act) provided for the initiation and follow-up of anti-cartel enforcement, but only through general provisions against restrictive and unfair trade practices. The new Act, however, specifically addresses cartel concerns. Considering the transnational nature of international cartels, the incorporation of the effects doctrine (that is inquiry into acts taking place outside India, but having an effect on the markets in India) in the new Act is facilitative to anti-cartel enforcement. However, India must ensure that the law is duly implemented. India must also develop effective techniques for investigating international cartels.

se, while others indict cartels for illegality only upon anti-competitive harm being caused to their economy. In some countries operating cartels is treated as a criminal offence.

The specific penalties provided for hard-core cartel activities in order of their usage are:

- Fines against enterprises;
- Fines against natural persons;
- Imprisonment of natural persons; and
- Recovery of damages by victims

Further penalties for natural persons imposed by a few countries are as follows:

- If it is a company director who commits a breach of competition law he may be disqualified from acting as a company director for a maximum period of 15 years; and

- Additional criminal penalties would include restitution orders, community service, orders not to leave the country, and supervision.

Personal liability, whether it be imposition of fines against natural persons or imprisonment of cartel operators can provide a strong impulsion for the decision-makers to abstain from cartel participation.

It may be noted that there is a trend towards imposing stronger sanctions. Several countries have recently reviewed, or are in the process of reviewing their laws and policies relating to cartels with a view towards increasing their enforcement efforts in this area. (OECD, 2002)

Optimum Deterrence

The principal purpose of sanctions in cartel cases is considered to be deterrence. Are current sanctions in national laws sufficiently stringent to provide effectual deterrence? Available data indicate that sanctions actually imposed have not reached the optimal level for deterrence.

In this context it is necessary to address a vital issue, which centres on just how far should deterrence go? For instance, in fining enterprises, should fines be levied to an extent when it may bankrupt individual companies, if such a fine satisfies the recommended level to achieve optimum deterrence? There is a general acceptance to the contrary. The rationale justifying such a contrary view might lie in the fact that pushing a company to bankruptcy always results in eliminating a competitor from the market and this might lead to monopolisation in the end.

Exposing Cartels: Policy Programmes and Tools of Detection

A crucial aspect of national response to discovery and proof of cartels is the investigative methods adopted by various competition agencies at the national level. Competition authorities have developed specific tools unique to cartel investigation. These are as follows:

Leniency Programmes

In its basic form, a leniency programme may promise to the first, and only the first business or individual to offer full co-operation with a cartel investigation, amnesty from sanctions for its conduct. While the programme may be extended to subsequent applicants offering additional information, the gap in rewards is usually substantial. This is to establish a clear incentive to inform at the earliest. A leniency programme can create a powerful incentive for a member to defect from a cartel and for would be cartellists not to join cartels. In recent years, leniency programmes have brought about successful prosecutions of many large, high profile cartels that would not otherwise have been discovered.

Box 3: Our competitors are our friend, our customers are the enemy

The Lysine tapes were undercover audio and videotapes recorded by U.S. Federal Bureau of Investigation (FBI) agents with the help of a co-operating witness. The tapes captured an international cartel in the act of fixing prices and carving up the worldwide market for the feed additive – lysine – a product used by farmers around the world. The tapes further exposed the cartel mentality, which was so contemptuous of its customers, and antitrust laws that it adopted the slogan: “Our competitors are our friend. Our customers are the enemy!”

The tapes provided conclusive evidence of the conspiracy. What has made these tapes such an effective deterrent is not just the unnerving notion that the FBI might be watching, but the fact that high-level executives went to jail and their companies paid heavy fines as a result of their cartel activity.

Source: Scott D Hammond, The Fly on the Wall has been Bugged, 2001

Apart from the above policy mechanism, other tools utilised in cartel investigations are *dawn raids*, which are basically unannounced visits to the offices of a suspected cartel participant to review and take away files; *electronic tracking* {in obtaining evidence stored in electronic form during searches and raids and in electronic eavesdropping such as videotaping secret cartel meetings} and *oral testimony*.

The International Anti-Cartel Regime

Since international cartels are transnational in scope, effective anti-cartel enforcement requires an active international approach to be adopted in conjunction with the national laws of countries.

Institutional Participation

International institutions, which have been involved with or are currently working on the legal and conceptual challenges of the shared commitment to fighting international cartels include amongst others the OECD, the International Competition Network, United Nations Conference on Trade and Development (UNCTAD) and the World Trade Organisation (WTO).

International institutional involvement is invaluable, as it promotes awareness in the public domain about just how harmful international cartels are, facilitates international co-operation, and assists in the capacity building of developing countries.

However, despite ongoing efforts, meaningful international co-operation among members for investigation of international cartels has not really been realised; it is impeded by each country's information protection laws. Much of the information acquired in the investigation, especially in case of leniency programmes is confidential, and thus cannot be shared with countries investigating the same cartel or even others for that matter. At times, even non-confidential information cannot be shared due to policy considerations.

A Multilateral Framework Agreement?

Should there be a multilateral framework on competition policy to deal with international cartels? Dialogue had been initiated to include provisions on cartels in a multilateral agreement on competition under the WTO, but the discussion has been stalled for the present. There are proponents and detractors of the aforementioned proposal and both sides have their range of compelling and vague arguments. But before even considering such arguments, it is necessary to realise that there are certain core issues, which unless resolved, render even the debate meaningless.

Should there be a multilateral agency to deal with international cartels, or a multilateral agreement would provide only a framework for cooperation, leaving the job of discovering and proving a cartel at the national level. The framework that had been proposed at the WTO was based on the latter option. Developing countries lacking the requisite resources and technical expertise would find it very difficult to break international cartels without substantial co-operation from developed ones. This level of co-operation may not be forthcoming in view of confidentiality requirements. How then, will the proposed agreement be able to provide for credible mechanisms safeguarding the interests of both developing countries as well as developed countries? Other concerns would include, for instance, that many developing countries do not yet have the expertise to negotiate on competition issues and also that the primary motivation of developed countries of having such an agreement is considered to be market access rather than consumer protection. Also, deciding the forum to pursue such an agreement is of vital importance. Given the need for co-operation over compulsion, the WTO, for instance, may not be the appropriate forum. It is imperative to address these issues before there can be any meaningful discussion and perhaps there can be an alternative forum other than the WTO (Mehta et al, 2005).

Bilateral Agreements

International co-operation may also be achieved by the means of bilateral agreements. Issues covered by

such bilateral agreements include investigatory co-operation, jurisdictional issues and the sharing and exchanging of confidential information, when allowed under a nation's laws. The US is particularly prolific in signing such agreements, although whether or not this leads to active co-operation on their part is another matter altogether.

Box 4: Developing Countries – Future Prospects

Developing countries have nascent competition regimes not yet equipped to handle cross-border anti-competitive practices and even if their laws are adequate, most of these countries lack the muscle to enforce such provisions given the political pressure from the home countries of cartel members. How then can the concerns of the developing countries in relation to international cartels be resolved?

A multilateral framework agreement at the WTO remains an option, but as aforementioned remains fraught with problems. However in the long-term, such an agreement, perhaps in another forum, may certainly be considered.

In the short term, awareness creation and capacity building ought to be focused upon with the assistance of international organisations such as UNCTAD, International Competition Network (ICN) and OECD and that of the developed countries as well. Bilateral and regional agreements in this context would be helpful. Regional co-operation may prove beneficial, as in the case of developing countries and the power imbalance in global markets; the threat of joint action by many countries may be more effective than the retaliation of a single developing country.

The Way Forward

There are a plethora of recommendations from various sources on facilitating anti-cartel enforcement; certain key recommendations are as follows:

- With full appreciation of the detriment caused by cartels, bringing about an effective anti-cartel regime will be easier. Adequate awareness does not yet exist. It is necessary therefore to promote better understanding of the harmful effects of international cartels.
- Cartel operators are becoming increasingly sophisticated and correspondingly adept in concealing evidence. It has therefore become essential that information-gathering techniques aimed at the discovery and proof of international cartels be given particular attention.

A 'best practices' clearing house should be established for the sharing of evidence gathering techniques, strategies, tools, experts, and contacts.

- Sanctions should be developed such that they provide optimum deterrence. Experts in the field should be duly consulted. Suggested strategies include that fines against participating firms ought to be three times the gains made through cartelisation (known as treble damages) and that personal liability be fixed.
- International enforcement co-operation ought to be adequately strengthened. Confidentiality requirements continue to hinder international co-operation. It is felt that firms would not apply for amnesty provided by leniency programmes, if they believe that the information provided to the enforcement agency will be shared and result in liability in jurisdictions, which do not have a transparent and predictable amnesty policy, including information safeguards. Disincentives to apply for amnesty would hamper discovery of cartels and thus the emphasis on confidentiality. The issue may perhaps be resolved by greater convergence in national amnesty policies.
- There should be greater bilateral and more regional / plurilateral co-operation.
- Vigilance should not end with a cartel's punishment, as former price-fixers often try to effectively restore their former market positions by merging or by taking other steps that lessen competitive pressures and raise prices.

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