

Corruption in market competition: collusion and cartels

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A recent and dramatic development in cartel prosecutions has been the discovery of very large cartels that operated internationally; some of them were worldwide in scope. Their participants were multinational companies headquartered in different countries.

OECD, 2003²

Cartels are viewed as 'the supreme evil of antitrust'.³ Cartels and other collusion schemes can gain enormous anticompetitive rents that wreak havoc on consumers and the world economy. No product or service is immune. Price-fixing and collusion schemes have been found to penetrate markets from food and vitamins to the most arcane chemical compounds, from industrial inputs and infrastructure projects to the most sophisticated high-tech information technology (IT) and health products, as well as consumer services.

By one estimate, a first wave of cartels in international trade in the 1920s and 1930s accounted for 40 per cent of world merchandise trade and prompted anti-cartel action in key trading countries.⁴ After more than fifty years of relatively low visibility and low prosecution rates, a new and at least equally pernicious and potent wave of globalised cartel activity has been sweeping through the world since the 1980s, riding on ever cheaper international communication and the globalisation of economic production networks.

More than 283 private international cartels that were discovered between 1990 and 2005 chalked up aggregate sales of some US\$1.2 trillion and caused direct economic losses to consumers through overcharges of US\$300 billion. In the early 2000s about thirty-five such cartels were being discovered each year, and worldwide corporate penalties totalled about US\$2 billion per year.⁵

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2 OECD, *Hard Core Cartels: Recent Progress and Challenges Ahead* (Paris: OECD, 2003). 3

Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398 (2004).

4 C. D. Edwards, *Economic and Political Aspects of International Cartels* (New York: Arno Press, 1976).

5 J. M. Connor and C. G. Helmers, *Statistics on Modern Private International Cartels, 1990–2005*, Working Paper no. 06-11 (West Lafayette, IN: Department of Agricultural Economics, Purdue University, 2006); see also J. Chowdhury, *Private International Cartels: An Overview*, Briefing Paper no. 5 (Jaipur: CUTS Centre for Competition, Investment & Regulation, 2006).

The nexus between cartels and corruption

Cartels and collusion schemes are both illegal and immoral, just like bribery – the more classic type of corruption. Bribery and cartel formation often employ similar strategies of deceit and cover-ups, such as off-budget slush funds, hidden communication links or the use of go-betweens. They also nurture and feed on the same corporate climate of moral ambiguity and reckless opportunism that undermines corporate integrity standards and respect for the law more broadly.

It is not surprising, therefore, that price-fixing and bribery often go hand in hand in the case of bid-rigging, and manipulating public procurement and tendering processes. A review of more than 230 cartel cases found that almost a third were related to bid-rigging.⁶ Many companies tend to delicately layer unfair and anticompetitive behaviour. Similarly, corporate bribery facilitates and smoothes the functioning of cartels.

In India, for example, a review of several multimillion-dollar, World-Bank-funded projects in the health sector found multiple incidences of possible fraud, corruption and collusion of suppliers. As part of a US\$114 million anti-malaria project in India, four European chemical companies were alleged to have formed a cartel in 1999 to submit identical bids to supply pyrethroid insecticides, equally divide the contracts among themselves, inflate prices and limit competition from companies submitting lower bids.⁷ Figure 3 shows the market shares during and after the suspected collusion.

Bribery and cartel formation also harness very similar mechanisms for disguising their activities and they thrive on the same corporate culture of ruthless opportunism. Fighting one without dealing with the other would leave intact the very disregard for the law and the very organisational mechanisms for working around it that abet cartels and bribery alike. Thus a starting point for a successful antitrust enforcement strategy is a comprehensive approach for curbing corporate white-collar crimes and offences. Only a holistic, uncompromising approach to anti-corruption and anti-collusion compliance is likely to yield sustainable and credible improvements in corporate integrity.

Wiping out the development aid dividend

Developing countries are particularly vulnerable. Relatively weak antitrust laws and enforcement capabilities seem to invite more intense price-fixing activities, by both domestic and international cartels.⁸ International cartels are found to have significantly higher overcharges in Latin America and Asia than in North America and the European Union.⁹

6 J. M. Connor and Y. Bolotova, 'Cartel Overcharges: Survey and Meta-Analysis', *International Journal of Industrial Organization*, vol. 24, no. 6 (2006).

7 M. Voith, 'Collusion Alleged among Pyrethroid Makers', *Chemical & Engineering News*, 24 January 2008.

8 D. D. Sokol, 'Monopolists without Borders: The Institutional Challenge of International Antitrust in a Global Gilded Age', *Berkeley Business Law Journal*, vol. 4 (2007); D. D. Sokol, 'What Do We Really Know about Export Cartels and What Is the Appropriate Solution?', *Journal of Competition Law and Economics*, vol. 4, no. 3 (2008).

9 J. M. Connor and Y. Bolotova, 2006.

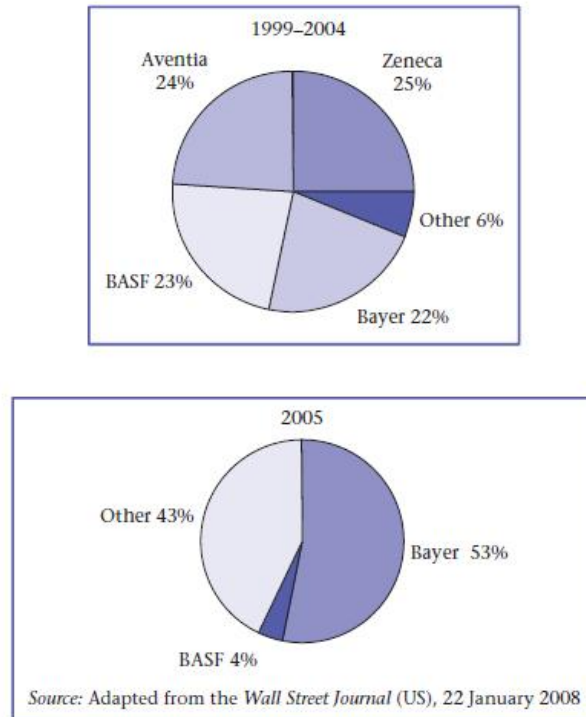


Figure 3: Share of pyrethroid contracts won

The consequences are devastating. In 1997 alone developing countries imported US\$54.7 billion of goods from a sample of nineteen industries participating in price-fixing conspiracies. These imports accounted for 5.2 per cent of total imports and 1.2 per cent of GDP in these countries. Even with a very conservative estimate of a 10 per cent price increase through over-charging, these nineteen cartels caused direct economic losses to the countries, equivalent to 15 per cent of the foreign aid they received.¹⁰

This is only the tip of the iceberg. Experts estimate that as few as between one in three and one in six cartel cases is being detected¹¹ and that average overcharge rates may actually be closer to 30 per cent.¹² This means that direct economic losses due to overcharges by international

10 M. Levenstein, L. Oswald and V. Suslow, *International Price-fixing Cartels and Developing Countries: A Discussion of Effects and Policy Remedies*, Working Paper no. 53 (Amherst, MA: Political Economy Research Institute, University of Massachusetts, 2003).

11 OECD, 2003.

12 M. Levenstein, L. Oswald and V. Suslow, 2003; J. M. Connor and Y. Bolotova, 2006.

cartel activities alone could match or even exceed the total volume of development aid given to developing countries. Price increases have ranged from 10 per cent for thermal fax paper, to 35 per cent for vitamins to 100 percent for stainless steel.¹³

These overcharges also stifle longer-term development opportunities. They raise the prices of vital inputs for fledgling local industries and make it more difficult for them to compete internationally. They drain public budgets for essential infrastructure and health projects, impeding social development. Moreover, they make basic food items and essential health services even less affordable to the millions of poor households that live on less than US\$1.25 per day.¹⁴

Comprehensive and aggressive antitrust enforcement is a must, as price-fixing and overcharging, bid-rigging and the carving up of geographic markets and customer groups through collusion affect countries across the globe at very different stages of development.

Tools for effective enforcement

Limited awareness about the scale, scope and pernicious impact of cartels has meant that, until very recently, only a handful of industrialised countries, including the United States, Canada and some EU countries, have pursued real efforts to tackle cartels. Even in these countries enforcement has waxed and waned considerably. Fortunately, the last decade has seen a remarkable awakening of anti-cartel action in several countries. Countries such as Brazil, Japan and South Korea have stepped up their cartel prosecution activities.¹⁵ China's new anti-monopoly law entered into force in August 2008,¹⁶ and India is expected to follow suit with a stronger competition law in 2009.¹⁷

Meanwhile, the legal framework and toolbox for fighting cartels is growing and becoming more refined. In addition to the core deterrents of civil liability and administrative fines (typically up to 10 per cent of sales value), new enforcement measures include the following carrots and sticks.

Higher public fines and compensation for private damages

Penalties imposed on cartel participants have risen significantly over the past decade, with fines of tens or even hundreds of millions of dollars becoming increasingly common.¹⁸ The highest fine to date for a single firm was meted out by the European Union in 2007, when it

13 Y. Yu, 'The Impact of Private International Cartels on Developing Countries', Honors thesis, Stanford University, CA, 2003.

14 US\$1.25 per day is the official poverty line defined by the World Bank; see <http://go.worldbank.org/K7LWQUT9L0>.

15 D. D. Sokol, 2007; *Financial Times* (UK), 10 June 2008.

16 *Financial Times* (UK), 28 July 2008.

17 See article starting on page 258.

18 J. M. Connor and C. G. Helmers, 2006.

fined ThyssenKrupp of Germany nearly €480 million for working with three other companies to rig the elevator and escalator market in four EU countries.^{19,20}

In order to strengthen deterrence and enforcement, several jurisdictions have also made it easier for private parties affected by cartels to sue cartel participants for damages and compensation, though this tactic is still mainly confined to the United States.²¹

Criminal penalties

Strong antitrust sanctions against companies are not as efficient a deterrent as criminal sanctions against individuals. So far, however, running a cartel constitutes a crime punishable by imprisonment and/or fines in only a few countries, including France, Germany, Ireland, Japan, the United Kingdom and the United States. More countries are now adopting this strategy.

Leniency for early defectors

A partial or even full suspension of fines for those who report cartel activities to the authorities has proved to be an extremely successful instrument in revealing and prosecuting cartels. At the EU level, for example, a 2002 leniency programme for cartel defectors that included full amnesty to the first and most cooperative defectors led to an upsurge in disclosures and fines. The programme enabled the European Commission to take nineteen actions involving more than 100 companies for a total of nearly €3 billion (US\$3.12 billion) in fines in 2002 and 2003 alone.²²

Disclosure: rewards for individual informers

Monetary incentives may also be used to encourage disclosure. The UK Office of Fair Trading offers whistleblowers up to £100,000 for providing information on cartels.²³ In the United States, the False Claims Act, which provides financial incentives to whistleblowers, has been used extensively to attack fraud in procurement.²⁴

Leniency can also be effective. The US Department of Justice has proactively approached companies suspected to be part of cartels to lay out clearly the advantages of leniency programmes for defectors.

19 International Competition Network, *Setting of Fines for Cartels in ICN Jurisdictions, Report to the 7th ICN Annual Conference, Kyoto, April 2008* (Luxembourg: Office for Official Publications of the European Communities, 2008).

20 BBC News (UK), 21 February 2007.

21 OECD, 2003.

22 C. Aubert, P. Rey and W. Kovacic, 'The Impact of Leniency and Whistle-blowing Programs on Cartels', *International Journal of Industrial Organization*, vol. 24, no. 6 (2006).

23 Reuters (UK), 29 February 2008.

24 C. Aubert, P. Rey and W. Kovacic, 2006.

Anti-cartel coalitions in procurement

Integrity pacts, conceived and promoted by Transparency International, provide a framework for national governments and potential suppliers to make explicit commitments to honest conduct when bidding for public tenders, and to instil a mutual sense of trust that no one will resort to bribery or bid-rigging.

Sending signals to investors and consumers: ethical blacklisting

In a different form of blacklisting, the Norwegian Competition Authority has begun to remove companies convicted of violating competition regulations from listings on ethical investment indices and funds. With these ethical funds and indices increasing investor awareness of ethical issues, such blacklisting is sending out a strong message about the unacceptability of anti-competitive crime.²⁵ Naming and shaming can also be taken further. Under Brazil's competition law, cartel operators can be ordered to pay for a summary of their offences to be published in a newspaper.²⁶

The way forward

On a positive note, the close links between corruption and cartels offers opportunities for mutual learning about innovative enforcement strategies. The great success of whistleblower programmes and the lessons learnt on how to design them can inform similar efforts with regard to corruption and vice versa. The potential synergies go well beyond mutual learning, however. When bribery and price-fixing coincide, as in the area of public procurement, competition authorities and anti-corruption authorities may find it useful to expand their cooperation and information-sharing. Exposing firms colluding to bribe their way through a public tender process may hint at the possibility of a more systematic collusion in the broader market. Likewise, the revelation of cartels in a specific industry may prompt the authorities to review public tenders for the same products for potential bid-rigging and explore the possibility of claiming compensation for cartel-related damages.

Last but not least, these synergies and the pooling of resources also apply to civil society groups and their research and advocacy activities. Consumer organisations have been leading research and advocacy efforts for better antitrust regimes. Good governance advocates have long built expertise and raised awareness on tackling corruption and strengthening public and corporate integrity.

More enforcement capabilities, stronger legal frameworks with substantial fines and criminal liabilities, and the more effective use of refined incentive mechanisms such as leniency and transparency initiatives are of common concern to trust-busters and corruption fighters alike. International organisations, civil society groups and national governments should devise concerted actions to solve the complex and interlinked problems of corporate bribe-paying

²⁵ 'Blacklisting May Strengthen the Fight against Cartels', Norwegian Competition Authority, 15 May 2008.

²⁶ International Competition Network, 2008.

and international cartels. It is high time to compare notes on the pernicious symbiosis of corruption and cartels and work together more closely to strengthen corporate integrity in a comprehensive manner.

Despite the surge and expansion of anti-cartel enforcement, the fight is only beginning. Worldwide, median cartel penalties are estimated to recoup only about 20 per cent of direct overcharges.²⁷ High-profile cases of cartels, very often involving the most respectable brand names in business, continue to hit the headlines around the world.²⁸ Likewise, recidivism remains high, as 170 companies that participated in cartels between 1990 and 2005 have been found to be repeat offenders.²⁹ All this indicates that deterrence is still not effective, and a sense of impunity prevails even in the most advanced economies.

In addition, cartels are increasingly operating globally, while many developing countries can barely muster the resources and determination to fight entrenched local cartels, not to mention the price-fixing of imports. All this is compounded by irresponsible 'beggar-my-neighbour' behaviour: as recently as 2005 the regulatory frameworks of at least fifty-one, mainly OECD, countries were still found to tolerate, explicitly or implicitly, export cartels that engaged in price-fixing outside their own countries.³⁰ This makes stronger international cooperation and a further strengthening of anti-cartel efforts around the world a priority, to make markets work better, create development opportunities and strengthen overall corporate integrity.

27 J. M. Connor and C. G. Helmers, 2006.

28 For example, *The Economist* (UK), 1 May 2008.

29 J. M. Connor and C. G. Helmers, 2006.

30 M. Levenstein and V. Suslow, 'The Changing International Status of Export Cartels', *American University International Law Review*, vol. 20, no. 4 (2005).