

Hard Core Cartels – Harm and Effective Sanctions

Introduction

Hard core cartels, or agreements among competitors fixing prices, rigging bids (collusive tenders), restricting output or dividing markets, are the most serious and harmful violations of competition law. They injure consumers by raising prices and restricting supply. They create market power, waste and inefficiency in countries whose markets would otherwise be competitive.

It is generally understood that cartels are harmful, but the extent of the harm that they cause is not well known. It is important to understand how cartels harm consumers and to appreciate the magnitude of that harm. Such an understanding will lead to more effective action against this conduct, including the imposition of more effective sanctions against cartel participants. The OECD has conducted a study of these topics – the harm caused by hard core cartels and effective sanctions against them – the results of which are described below. The study is described in more detail in a report published in 2002 by the OECD's Competition Committee, *Report on the Nature and Impact of Hard Core Cartels and Sanctions against Cartels under National Competition Laws*. ■

How much harm is caused by cartels?

Cartels harm consumers and have pernicious effects on economic efficiency. A successful cartel raises price above the competitive level and reduces output. Consumers choose either not to pay the higher price for some or all of the cartelised product that they desire, thus forgoing the product, or they pay the cartel price and thereby unknowingly transfer wealth to the cartel operators. Further, a cartel shelters its members from full exposure to market forces, reducing pressures on them to control costs and to innovate. All of these effects adversely affect efficiency in a market economy.

It is not easy to quantify these effects, however. It would require comparison of the actual market situation under the cartel to that which would exist in a hypothetical competitive market. Competition officials usually do not undertake to make such a calculation, both because it is difficult to do and because their laws usually do not require it.

When an estimate of harm is necessary, however, most officials employ a proxy, which is the unlawful gain accruing to the cartel members from their activity. In its simplest form, this estimation is the product of the cartel "mark-up" above the competitive price and the commerce affected (in units) by the cartel agreement. Even this calculation can be difficult, as it requires an assessment both of the amount of "affected commerce" and of what the "competitive" price would have been absent the agreement.

How much harm is caused by cartels?

Do cartel operators know that their conduct is unlawful?

What is required for a sanction to be an effective deterrent?

How can strong sanctions make it easier to detect cartels?

Do national competition laws provide for sufficiently strong penalties against cartels?

What sanctions are currently being imposed against cartels?

Are current sanctions sufficiently strong to provide an effective deterrent?

In summary

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The OECD's Competition Committee conducted a survey of cartel cases conducted by its Members between 1996 and 2000, in an attempt to learn more about the harm from cartels. The responding countries described a total of 119 cases, but in many of these it was not possible to estimate harm. Still, the amount of commerce affected by just 16 large cartel cases reported in the OECD survey exceeded USD 55 billion world-wide. The survey showed that the cartel mark-up can vary significantly across cases, but in some it can be very large, as much as 50% or more. Thus, it is clear that the magnitude of harm from cartels is many billions of dollars annually. ■

Do cartel operators know that their conduct is unlawful?

Cartel operators can go to great lengths to keep their agreements secret, showing that they fully realise that their conduct is harmful and unlawful. In some cases, they are explicit in their contempt for the competitive process.

The results of the OECD survey provided examples of measures taken by cartel conspirators to hide their actions. Conspirators in one case, faced with a document demand from the competition authority, loaded two automobiles with bid files and took them to the country, where it took a full day to burn them in "four huge bonfires". In another case, the conspirators carefully controlled the creation and retention of incriminating documents by, among other things, conducting internal audits to verify that such documents no longer existed. When it was felt necessary to keep certain spreadsheets showing allocations of business among the conspirators, the files were copied onto computer disks and hidden in the eaves of one employee's grandmother's house. In another case, internal documents from one of the defendants revealed an unofficial motto of the company: "Our competitors are our friends, our customers are the enemy." ■

What is required for a sanction to be an effective deterrent?

The principal purpose of sanctions in cartel cases is deterrence. An effective deterrent should take away the prospect of gain from cartel activity. But not all cartels are uncovered and punished. Thus, if someone were contemplating entering into a cartel, that person would take into account not only the amount of expected gain but also the likelihood that the cartel would be discovered and sanctioned. Many experts contend, therefore, that in the cases where there is successful prosecution, the total fine against the participating organisations should exceed the gain that they realised from the cartel. If, for example, the chances that any given cartel would be discovered and punished were one in three, then a fine that would provide an adequate deterrent would have to

be three times the actual gain realised by the cartel. Some believe that as few as one in six or seven cartels are detected and prosecuted, implying a multiple of at least six. A multiple of three is more commonly cited, however.

To impose such a fine requires a calculation of the gain realised by a cartel. Determining the gain, as noted above, can be difficult. Some experts recommend employing a proxy when the gain cannot be calculated, such as a percentage of total turnover of the participants. Whether or not it is possible to calculate accurately an optimal fine against enterprises, however, in practice it could be difficult to implement it. In some cases, the optimally-sized fine would be so large as to bankrupt the organisation, causing it to exit the market, a result that some competition agencies would want to avoid. Thus, there can be a place for sanctions against natural persons, placing them at risk individually for their conduct. Such sanctions can provide an overall enhancement to deterrence. ■

How can strong sanctions make it easier to detect cartels?

Strong cartel sanctions also provide an incentive for cartel participants to defect from the secret agreement and provide information to investigators. The threat of very large fines against organisations for cartel conduct creates an incentive for them to defect from the cartel and to offer co-operation to the investigators in exchange for leniency in punishment. Similarly, the threat of strong sanctions against individuals provides added incentives for those individuals to "blow the whistle" on cartel conduct and to offer co-operation to government investigators in exchange for reduction or elimination of the punishment. To take advantage of these incentives, many countries now have formal "leniency programmes", under which an enterprise that is the first to offer co-operation in a cartel investigation is either excused from punishment or receives a lesser sanction. ■

Do national competition laws provide for sufficiently strong penalties against cartels?

The competition laws of most countries provide for the imposition of large fines against organisations for cartel conduct. The maximum fines in these laws are expressed either in absolute terms or as a percentage of the annual turnover of the respondent company. Without more experience in assessing the unlawful gain realised by cartels, it is difficult to know whether these maximums are sufficiently large to accommodate the desired multiples of that gain. One benchmark in this regard might be the new law in New Zealand, which recently completed an in-depth study of optimal sanctions in cartel cases. The maximum fine provided

in that law is the greater of three times the unlawful gain, NZD 10 million (the equivalent of approximately EUR 4.8 million) or, if the commercial gain cannot be readily asserted, 10% of the total turnover of the enterprise. In most countries whose laws contain absolute maximum fines the maximum is below the equivalent of NZD 10 million. Several of these countries have as an alternative maximum, however, 10% of total turnover of the respondent, which is consistent with the New Zealand standard.

In several OECD countries, but less than half, natural persons can be fined for cartel conduct, often for very large sums. The laws of nine OECD countries provide for imprisonment of natural persons. Fourteen countries permit the recovery of money damages by cartel victims. ■

What sanctions are currently being imposed against cartels?

Some countries are now imposing very large fines on enterprises for cartel conduct, but others have not yet begun doing so. The OECD survey showed that ten countries had imposed organisational fines in excess of the equivalent of USD 1 million within the survey period of 1996-2000. In three countries the largest fines were in excess of USD 100 million. In two the largest fines were between USD 10 million and 100 million and in the remainder the largest were between 1 and 10 million. Within the survey period these large fines increased in number and severity in the later years. In the remaining countries, however, no fines exceeded USD 1 million and in some the fines were small or nonexistent.

Only four countries had imposed fines on natural persons. In three of the four the largest fines exceeded the equivalent of USD 100 000. Only two countries, Canada and the United States, had imposed sentences of imprisonment on natural persons, and the US was by far the leader in this regard. It imposed 28 such sentences in 1999 and 18 in 2000. The average length of those sentences was approximately 8 months in 1999 and 10 months in 2000. While the possibility for the recovery of money damages by cartel victims exists in several countries, in only the United States is the practice common.

There is a trend toward imposing stronger sanctions, however. Several countries have just completed or are in the process of reviewing their laws and policies relating to cartels, with a view toward increasing their enforcement efforts in this area. ■

Are current sanctions sufficiently strong to provide an effective deterrent?

Available data indicate that sanctions actually imposed have not reached the optimal level for

deterrence. The OECD survey permitted comparison of financial sanctions with the cartel gain in a relatively few cases. The fines, expressed as a percentage of the gain, varied widely, from 3% to 189%. In only four cases, two from the United States, one from Canada and one from Germany, were the fines more than 100% of the estimated gain, and in no case was the fine as high as two or three times the gain, as recommended by some experts. Thus, it must be concluded that, while there is a distinct, if uneven trend toward more rigorous sanctions in cartel cases, available data indicate that larger sanctions are required to achieve effective deterrence. ■

In summary

The key points of this work on the harm from cartels and sanctions that are applied to them are as follows:

- Cartels cause significant harm to consumers worldwide, amounting to many billions of dollars per year.
- The principal purpose of sanctions against cartels is deterrence. Strong sanctions also provide an incentive for cartel members to defect from their conspiracy and to co-operate with the investigating authorities. Strong sanctions make leniency programs work.
- Many experts contend that effective financial sanctions against organisations participating in a cartel should be at least two or three times the gain that the cartel generates for its members. Calculating cartel gains for the purpose of arriving at the appropriate fine is difficult, however, and there are also obstacles to imposing such large fines in some cases. Thus, sanctions against individual cartel participants can provide important additional deterrence.
- Some countries have imposed very large fines, in the equivalent of tens or hundreds of millions of dollars, against organisations in cartel cases. Many other countries have not yet begun doing so, however. Few countries currently sanction individuals for cartel conduct.
- While there is a trend toward stronger sanctions in cartel cases, available evidence indicates that current sanctions are not sufficiently large to provide an effective deterrent against such conduct. ■

For further information

The *Report on the Nature and Impact of Hard Core Cartels and Sanctions against Cartels under National Competition Laws* is available on the OECD's competition policy website, at www.oecd.org/daf/competition. Additional information on this topic can be obtained from: John Clark, Tel.: (33-1) 45 24 78 60 (E-mail: john.clark@oecd.org). ■

For further reading

- **OECD Recommendation of the Council concerning effective action against hard core cartels**, free on Internet: www.oecd.org/daf/competition (click on “Recommendations”).
- The **OECD CLP Journal**, Vol. 2/No. 2.
- The publication on **Fighting Hard Core Cartels – Harm, Effective Sanctions and Leniency** (forthcoming), ISBN 92-64-19735-4, Euros 30, 110 p.
- **OECD Resources on Competition Law and Policy** can be found at www.oecd.org/daf/competition.

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Public Affairs and Communications Directorate.
They are published under the responsibility of the Secretary-General.

Where to contact us?

FRANCE

OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: 33 (0) 1 45 24 81 81
Fax: 33 (0) 1 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD BERLIN Centre
Albrechtstrasse 9/10
D-10117 BERLIN
Tel.: (49-30) 2888353
Fax: (49-30) 28883545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN

OECD TOKYO Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0036/0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD MEXICO Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560
MEXICO, D.F.
Tel.: (00.52.55) 5281 3810
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet: www.rtn.net.mx/ocde

UNITED STATES

OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

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