

Evaluating and Understanding a Competition Authority

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"To Enforce and Comply: Incentives Inside Corporations and Agencies"
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Introduction

What do we want a competition authority to do?

- Cartel policy
 - Desistance - discover and shut down cartels
 - Detection
 - Prosecution
 - Deterrence - discourage cartel formation
 - Penalize cartels
- Merger policy
 - Efficient evaluation of mergers
 - Prevent mergers that reduce welfare.
 - Restructure mergers so that they are not harmful.
 - Evaluation at minimal cost.
 - Welfare-enhancing self-selection
 - Create guidelines and establish a reputation.
 - Achieve transparency and predictability.

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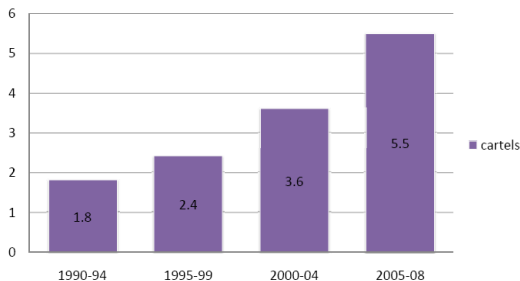
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Rates of Discovery by the European Commission Rise Steadily



Source: John Connor, "Cartels and Antitrust Portrayed: Private International Cartels, 1990-2008," December 2008.

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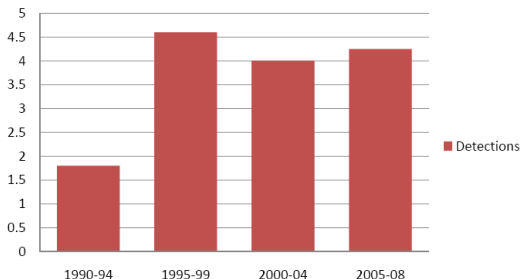
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Cartel Detections by the US and Canada Are Stalled



Source: John Connor, "Cartels and Antitrust Portrayed: Private International Cartels, 1990-2008," December 2008.

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- Welfare is not observed.
- The cartel rate is not observed.
 - Is the lack of cartel cases evidence of failure?
 - *Because detection is weak.*
 - Is the lack of cartel cases evidence of success?
 - *Because deterrence is strong.*
- How do you then make a CA accountable?

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- 1 What is the objective of a competition authority?
- 2 Are there inherent biases due to how performance is measured and rewards are determined?
- 3 What are the implications for detection, prosecution, and penalization?
- 4 How can policy be designed to correct any biases?

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- 1 How is the performance of a CA measured?
- 2 What form do rewards take?
- 3 How does performance determine rewards?

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Thomas Barnett, Assistant Attorney General - Congressional
Testimony (Sept. 25, 2007)

"The Division set a record for the most jail time imposed (almost 30,000 jail days); obtained the second highest amount of fines in the Division's history (over \$630 million); and succeeded in obtaining the longest jail sentence for a foreign national charged with an antitrust offense (14 months)."

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William Kovacic, Federal Trade Commission, Chairman -
Congressional Testimony (May 14, 2008)

"The Commission shares the concerns of lawmakers, businesses, and American consumers about rapidly increasing prices for crude oil, gasoline, diesel fuel, and natural gas, and currently engages in a wide range of activities to prevent improper industry conduct causing such price rises. ... In the past year, we have acted to block acquisitions in the natural gas and petroleum industries that we believed could raise prices to consumers."

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Neelie Kroes, European Commissioner for Competition Policy

- Consumers at the Heart of EU Policy (April 22, 2008)

" ... we calculate that the direct future customer savings resulting from our cartel, antitrust, liberalisation and merger cases in 2007 alone, is at least €13.8 billion. About €30 in the pocket for each of Europe's 500 million citizens. And then there are the obvious deterrent effects we cannot put a price on. "

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Competition: making markets work better



- In Defence of Competition Policy (October 13, 2008)

"Enforcement may have been lacking in some financial regulators, but never in competition policy. Taking the example of cartels: €6 billion in direct consumer benefits have been delivered in the last four years."

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- What is said?
 - EC provides estimates of the gain in consumer welfare.
 - Emphasis on shutting down cartels and penalizing them, not deterring them.
 - Mergers blocked.
 - Achieving milestones - higher fines, longer jail sentences.
- What is not said?
 - How many active cartels are there?
 - How many cartels are not being formed because of competition policy?
 - What is the change in the average price-cost margin due to competition policy?

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- Intrinsic rewards
 - Intrinsic well-being from improving social welfare.
 - Do the more benevolent go to work for the government?
 - Do the more benevolent rise to the top?
- Internal extrinsic rewards
 - Promotion - status, increased authority
 - Larger budget size
 - Larger salary
 - More influence

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- External extrinsic rewards
 - CA attorneys hired by law firms.
 - DOJ Deputy Assistant Attorney General James Griffin is now a partner at King & Spalding.
 - DOJ Deputy Assistant Attorney General Gary Spratling is now a partner at Gibson, Dunn & Crutcher.
 - CA economists hired by economic consulting firms.

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How performance determines rewards

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- Observable performance
 - Any extrinsic rewards are only sensitive to *observable* measures of performance.
 - CA oversight only partially observes a CA employee's effort, decisions, etc.
 - Broader labor market observes even less than CA oversight.
- What makes a government attorney or economist attractive to a private firm?
 - Talent
 - Knowledge
 - Position

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- Are rewards linear in performance?
- Is a CA employee overly concerned with avoiding a really bad outcome?
 - With electric power regulation, avoid a blackout!
 - With cartel enforcement,
 - avoid losing a case in court
 - avoid passing on a case, only to see it pursued successfully by another agency or private litigants
- Is a CA employee overly concerned with realizing a really good outcome?
 - Getting a record-setting penalty, sending a Fortune 500 executive to jail
 - Setting a new legal precedent
 - Instituting a new policy.

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- Actions of a competition authority
 - Detection
 - Prosecution
 - Penalization
 - Evaluation of actions and policies
- Issues
 - Is there a tendency to favor desistance over deterrence?
 - Is there a tendency to focus more on prosecuting rather than discovering cartels?
 - Is there a tendency to avoid cases not involving leniency?
 - Is there a tendency to settle a case rather than pursue the most severe penalty?

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- Does a CA see itself as pursuing cases reported to it, or does it perceive its role as actively discovering cartels?
- Until the leniency program, the DOJ exclusively responded to complaints:

"As a general rule, the [Antitrust] Division follows leads generated by disgruntled employees, unhappy customers, or witnesses from ongoing investigations. As such, it is very much a reactive agency with respect to the search for criminal antitrust violations." (Antitrust Bulletin, 1991)

- Why was it not pro-active in discovering cartels?
 - Lack of resources?
 - Lack of ability to detect?
 - Bias against detection?

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- Screening is common with regards to a variety of crimes:
 - insider stock trading
 - tax evasion
 - credit card fraud
- Past attempts at screening for cartels in the U.S. have been mild.

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- Past attempts at screening for cartels in the U.S. have been mild.
 - Identical Bids Units of the DOJ in the 1950s
 - FTC Director Jon Baker used price increases after an industry-specific trough in demand to identify the exercise of market power.
 - FTC Director Luke Froeb made progress in developing a price variance screen.

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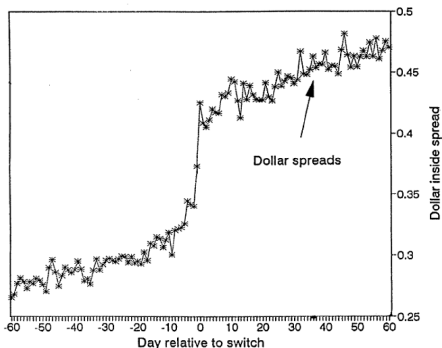
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- Is screening too difficult?
- Screening would have probably identified collusion in Nasdaq markets (W. Christie and P. Schultz, 1999)



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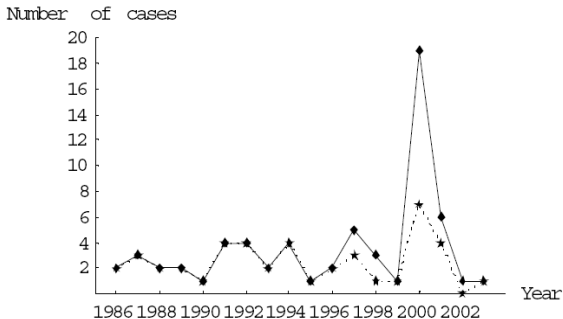
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- Possible reasons for why there may be under-detection
- Bias against screening
 - Cases found through screening may not be "easy".
 - Bureaucratic politics
 - Value of screening is *higher* with a leniency program
- For international cartels, there may be free-riding on detection by other CAs.

Behavior of a Competition Authority

Detection

- Number of EC cartel cases, 1986-2003 (S. Brenner, 2008)
 - Solid line: Number of EC cases.
 - Dashed line: Number of EC cases not triggered by U.S. investigation



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- If a CA doesn't want to engage in screening, should others be encouraged to do so?
- Korea Fair Trade Commission
 - 2005 - launched program
 - Whistleblower received a reward of almost €50,000 for information about a cartel among welding rod makers.
- UK's Office of Fair Trading
 - March 2008 - launched an 18-month pilot program.
 - Rewards of up to £100,000.
- U.S. False Claims Act
 - A non-government employee can file actions for fraud against federal government contractors.
 - Whistleblower is entitled to 15-25% of the government's total recovery.

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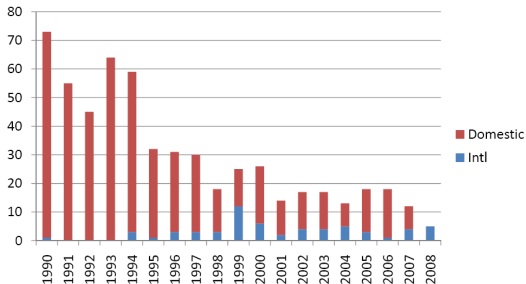
- Which cases to prosecute?
 - Domestic vs. international cartels
 - Industry size
 - Level of executives involved
 - Difficulty of the case - is there an informant?
- Are cases selected on the grounds that they will add to deterrence?
- Is there a bias for or against establishing precedent?
 - Higher chance of failure.
 - If successful, could dramatically add to the CA's reputation.

Behavior of a Competition Authority

Prosecution

- Domestic vs. international cartels (J. Connor, 2008)
 - What has happened to all of the domestic cartels?
 - Do they no longer exist?
 - Are they no longer prosecuted by the DOJ?

Number of Corporations Fined,
U.S. Dept. of Justice, 1990-2008



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- Airline Tariff Publishing Case (ATPCO)
 - Airlines were coordinating by announcing future price increases.
 - In 1994, the DOJ reached a settlement which involved the airlines not using those and other practices for ten years.
 - Without a trial, no legal precedent was set.
- Graphite electrodes
 - Mitsubishi does not manufacture graphite electrodes
 - Had a 50% ownership of manufacturer UCAR
 - Acted as a selling agent for manufacturers
 - All cartel members pled guilty except Mitsubishi.
 - DOJ took Mitsubishi to court

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M. Chang and J. Harrington (2008) - "The Impact of a Corporate Leniency Program on Antitrust Enforcement and Cartelization"

- Cartel birth and death
 - Birth: Firms form a cartel when given the opportunity and collusion is stable.
 - Death: Cartels internally collapse and/or are caught.
- Competition policy
 - Leniency program - optimally used by dying cartels.
 - Fraction of non-lenieny cases that are prosecuted (enforcement policy)
 - CA chooses enforcement policy to maximize the number of successful cases.
 - The bigger is the CA's caseload, the lower is the probability of winning a case.

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Results

- 1 Holding fixed the competition authority's enforcement policy, the introduction of a leniency program reduces the cartel rate.

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Results

- 1 Holding fixed the competition authority's enforcement policy, the introduction of a leniency program reduces the cartel rate.
- 2 Generally, the introduction of a leniency program results in the competition authority pursuing a less aggressive enforcement policy.

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Results

- 1 Holding fixed the competition authority's enforcement policy, the introduction of a leniency program reduces the cartel rate.
- 2 Generally, the introduction of a leniency program results in the competition authority pursuing a less aggressive enforcement policy.
- 3 The introduction of a leniency program can either lower or raise the cartel rate.

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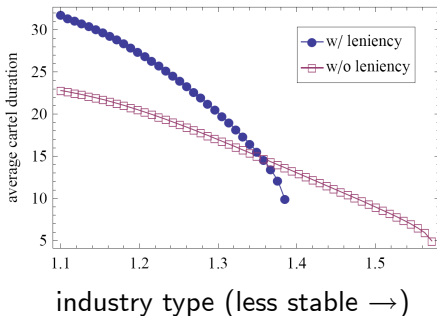
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ρ	Optimal Enforcement Policy		Cartel Rate	
	w/o leniency	w/ leniency	w/o leniency	w/ leniency
1.0	.9	.8	.280756	.198025
1.1	1. (*)	.9	.265363	.173012
1.2	.5	.9	.240116	.133414
1.3	.6	.4	.202972	.100516
1.4	.8	.3	.138895	.0938382
1.5	.6	.3	.0913201	.0810545
1.6	.5	.2	.0870105	.106969
1.7	.4	.2	.0986173	.104659
1.8	.4	.2	.092889	.101227
1.9	.4	.2	.0907345	.100516
2.0	.4	.2	.0886194	.10009

Behavior of a Competition Authority

Prosecution

- How can a leniency program raise the cartel rate?
 - Less stable cartels no longer form because of the leniency program.
 - More stable cartels have a smaller chance of detection because non-leniency enforcement is weaker.
- Fewer cartels form but they last longer.



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- Frank Easterbrook: "Deterrence is the first, and probably the only goal of antitrust penalties." (*University of Chicago Law Review*, 1981)
- Decisions
 - Plea bargaining in the US - settle or hold out for a harsher penalty?
 - How much evidence to require before awarding leniency?
- Is there an incentive to settle for penalties that are too low?
 - If penalties are high enough then the case earns three points for a win.
 - But higher penalties promote deterrence.

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- Vitamins case: Hoffman LaRoche
 - DOJ penalty guidelines: US\$1.3 to \$2.6 billion.
 - Actual fine: \$500 million.
- What was behind the penalty decision?
 - Was the DOJ content to have the largest fine in history?
 - Did the DOJ inadequately value deterrence?
 - Was avoiding a court case the proper use of limited DOJ resources?

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Evaluation: Cartel Policy

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- What are the incentives for a CA to assess the performance of its policies?
- How can we tell that an increase in penalties has reduced the cartel rate?
- How can we tell when a leniency program is working?

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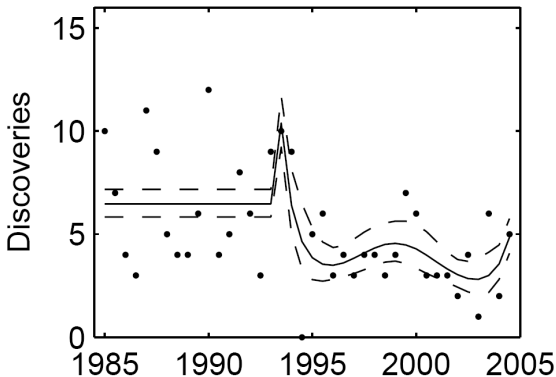
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- N. Miller, “Strategic Leniency and Cartel Enforcement” (*American Economic Review*, forthcoming)
 - Data: 1985 - 2005
 - Hypothesis #1: *If the 1993 revision resulted in an increase in the probability of discovery then there is an immediate rise in the number of discovered cartels.*
 - Hypothesis #2: *If the 1993 revision resulted in a decrease in the rate of cartel formation then the number of discovered cartels should adjust to a lower steady level.*

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Evaluation: Cartel Policy

- Actual and estimated number of DOJ cartel cases (over a six-month interval).



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Evaluation: Merger Policy

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- Evaluation of decisions regarding individual merger cases and merger policy (e.g., guidelines, use of market definition).
- Is the CA effective in predicting the effects of a merger?
 - Are CAs biased against post mortems?
 - Should the merged firm be required to conduct a post mortem?
- Is there a general reluctance for the government to engage in ex post evaluation?
 - Absence of many post-approval studies by the Food & Drug Administration.
 - Is it that officials are concerned about learning bad news?
 - Is it about process not outcomes?

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Research and Policy Agenda

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- Measuring performance
 - Develop methods for estimating the cartel rate.
 - Develop methods for estimating the impact of a policy change on the cartel rate
 - Leniency program
 - Higher financial penalties
 - Incarceration
 - Increased budget
 - Requires cooperation of competition authorities and academic economists.

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- Detection
 - Explore screening methods
 - Measure the impact of leniency on detection (distinct from prosecution)
 - Offer rewards to those who provide information on cartels.
- Prosecution
 - Explore impact of leniency program on enforcement.
 - What are the traits of cartels that use leniency?
 - Dying cartels?
 - Shorter duration?
- Penalization
 - Explore the value of discretion (plea bargaining), partial leniency.