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**Funding the budget of a competition
authority with the fines it imposes**

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Motivation of the paper - 1

Current ways for funding the budget of competition authorities:

1) *Governmental funds*

- They may jeopardize the independence of a CA

2) *Merger notification fees*

- Unpredictable
- Transaction costs
- Distortion in incentives



Motivation of the paper - 2

- Very few Competition Authorities (CA) are financed with their fines:
 - 1) Peru, Bulgaria (up to 25% of fines) and Portugal (up to 40% of fines)
 - 2) Hungary (up to 5 % and only for conferences and external research)
 - 3) Italy (only fines for infringements of the consumer protection legislation)
- As the current level of fines is low, a more extensive adoption of this sort of funding could align CA incentives for an optimal antitrust enforcement



Outline

- Competition policy (instruments, optimal policy)
- Suboptimal current competition policy
- Some possible explanations
- Funding fines as a correcting instrument
- Possible objections to the proposal



Competition policy: instruments and optimal policy

Two instruments:

- 1) Prioritization of cases
- 2) Average degree of severity (δ)

$$0 \leq \delta \leq 1$$

Optimal policy:

- 1) Priority to cases revealing the highest total damage ($N_i D_i$)
- 2) Fine = damage/probability of conviction

$$s_i^* = \frac{D_i}{P_i} = \frac{D_i}{\frac{n_i}{N_i}} = \frac{D_i N_i}{n_i}$$

Real fine: δs_i^*



Sanction trade off

- 1) the higher the fine the lower the incentive to infringe the law (deterrence)
- 2) The higher the fine the higher the incentive to appeal the CA decision and the lower the probability to be convicted by appeal courts



Direct and indirect (due to deterrence) impact : an optimal policy

- Impact of one year enforcement of antitrust policy

$$\max_{n_1 \dots n_z \delta} \sum_{i=1}^z \pi_i [\delta] (D_i (n_i + \gamma_i [\delta, n_i / N_i] (N_i - n_i)))$$

$$\text{s.t.} \quad \sum_{i=1}^z n_i = R$$

- D_i =damage of type “i” infringement
- n_i = number of cases of type “i” concluded in one year
- N_i =number of infringements of type “i”
- γ_i = deterrence due to action against type “i” infringement
- δ = degree of severity
- $\Pi_i [\delta]$ = probability that fines are confirmed by appeal courts
- Z = number types of infringements
- R = number (exogenously fixed) of cases a CA can complete in one year



Suboptimal competition policy: low level of fines:

1) Connor (2006): (in % of cartel injuries)

World: 39.8 % - European Union: 31.7 %

1) OECD (2003): "In the most cases sanctions are substantially below the optimal deterrence level"

- Recent European guidelines on quantification of fines seem to approach an optimal deterrence (Motta, 2008)



Explanation 1: accountability strategies

- No widespread assessment of the impact of competition policy by Independent agencies or Parliamentary bodies
- Competition Policy is accountable with respect to public opinion. Imperfect indicators:
 - 1) Press coverage of CA activities (more attention to cases involving well known firms)
 - 2) Degree of success before appeal courts (a fact which might trigger simple cases and lenient fine policy)



Explanation 2: career concerns

- Two different job perspectives of people belonging to governing bodies of CA:
 - 1) Consultant firm or academic position
 - 2) Politically appointed position
- We expect a milder fine policy if career perspectives of type 2 prevail



Possible distortion in the incentives of a real CA

- Myopic approach: it does not evaluate correctly the long run effect (on deterrence) of its intervention
- Distorted preference for cases involving well known firms (high D_i)
- An extreme situation (no fines):

$$\begin{aligned} \max_{n_1 \dots n_z} \quad & \sum_{i=1}^z \pi_i [\delta = 0] D_i n_i \\ \text{s.t.} \quad & \sum_{i=1}^z n_i = R \end{aligned}$$



Why European Commission can be different compared to other European CAs

- Accountability strategies:
 - Recent successes and strong cases due to leniency programs
- Career concerns:
 - Profiles of the last two Commissioners
 - Role of the Chief Economist
 - *These facts can explain a more vigorous fining policy by the European Commission*



Correcting mechanism: funding fines

- More incentives for a CA to impose higher fines
- A CA could be allowed to retain part of the fines successfully imposed
- These additional funds (with respect to public funding) should only be used for specific purposes: 1) temporary jobs; 2) monetary incentives to employees; 3) conferences and research



Antitrust enforcement with funding fines

$$\max_{n_1 \dots n_Z} \sum_{i=1}^Z \pi_i[\delta] n_i \delta s_i^*$$
$$\max_{\delta} \sum_{i=1}^Z \pi_i[\delta] \delta D_i N_i$$

$$\text{s.t. } \sum_{i=1}^Z n_i = R$$



Possible objections

1. Misbehaviour (negligible risk as all antitrust cases are appealed)
2. Distortion in the selection of activities (e.g. advocacy): negligible risk because most of the activities of a CA lead, directly or indirectly, to some fines)
3. Distortion in the selection of cases: only if the probability of conviction is unknown.
 - this risk can be handled by imposing some limits to the maximum fine which could be retained by the CA



Concluding remarks

- Standard (and very strong) assumption: *public enforcement = optimal policy*
- The common incentive structure of many CAs leads to suboptimal policy (low fines and distorted selection of cases)
- The aim of our proposal is to correct this distortion forcing a CA to increase the degree of severity

