ABSTRACT

Title: Governments as Cartel Victims

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In this note, I assemble simple empirical evidence on the severity of monetary penalties on modern international cartels, focusing on whether there are systematic differences in severity between cases in which the government itself is the victim of overcharging versus cases where the brunt of the economic injuries are borne by businesses and consumers. I find that government-sector fines are significantly higher relative to affected sales when government bid rigging is the principal form of cartel conduct. This pattern is found across nearly all jurisdictions. These findings call into question whether enforcement resources are tilted unwisely towards cases where the government is the victim.

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GOVERNMENTS AS CARTEL VICTIMS

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Do antitrust authorities treat themselves differently when they are the victims of illegal collusion as compared to corporate or individual citizens? That is, do antitrust agencies impose more severe sentences on perpetrators of conspiracies directed at government units than they do when the injured parties are not government bodies?

There is a large body of writings in the branch of economics known as Public Choice that critically examines the assumption of neutrality of politicians and civil servants that is common in the economics of taxation and spending (Tullock 1987). Tullock refers to this topic as the "Theory of Bureaucracy." The main hypotheses are that civil servants cannot always be counted on to reflect the priorities of their duly elected managers (a variation on the principal-agent problem) and that they make decisions that serve their self interests (job security, promotion, aggrandizement of authority, and perks). Some spotty empirical support exists for some of these hypotheses (*ibid.* p. 1043). However, as far as I know, the issue of disinteredness of enforcement of antitrust laws has not been empirically analyzed. Except perhaps the question of rent-seeking by firms subject to antitrust enforcement, neither has this issue been addressed in the field of law and economics.

In this note, I assemble simple empirical evidence on the severity of monetary penalties on modern international cartels, focusing on whether there are systematic differences in severity between cases in which the government itself is the victim of overcharging versus cases where the brunt of the economic injuries are borne by businesses and consumers. I find that government-sector fines are significantly higher relative to affected sales when government bid rigging is the principal form of cartel conduct. This pattern is found across nearly all jurisdictions.

Data Source

The sample of convicted global cartelists is drawn from an original data set, Private International Cartels (PIC), constructed by the author of this paper. PIC attempts to identify and collect information on the members, market characteristics, penalties, and other legal-economic dimensions of all international cartels discovered by any antitrust authority[1] since about January 1990 through December 2008. By members is meant the names of the companies and their executives that were identified by prosecutors as participants in illegal hard-core price-fixing schemes. Every cartel has members resident or headquartered

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[1] This term includes criminal law agencies like the DOJ, civil-administrative commissions like the EC, and national courts.

in two or more nations; *global* cartels operated in two or more continents. For a large proportion of the cartels we identified the revenues of the cartels during the collusive period ("affected sales"). Monetary sanctions include both government fines and the settlements reached in private damages suits. Finally, for a large minority of the cartels, PIC contains market price effects (the buyer overcharge) of these cartels. Details of data collection methods are in Connor and Helmers (2006).

At the end of 2008, PIC contained information on 516 formally investigated international cartels, of which 32 were eventually exonerated[2] and about 100 were still under investigation. More than 6000 companies are implicated as perpetrators; about 2900 ultimate parents are known by name and location. A few general dimensions of the data set: (1) the mean number of corporations per cartel is nine, but the number is highly skewed across cartels;[3] (2) median duration is 4.8 years and mean duration is 7.4 years; (3) two-thirds made industrial products, of which industrial intermediates were the majority; (4) almost half operated within Europe and 20% were global (and the latter also set prices in Europe).

I measure the severity of penalties (total penalties include fines and private settlements) by dividing by jurisdictional affected sales or, if global, world affected sales. Penalties and sales are available for 307 cartels: There are 50 cartels where the principal conduct is bid rigging of government tenders and 257 with private firms or consumers as the major buyers. The sample contains 60 U.S., 42 Canadian, 97 EU, and 53 other national penalties. In addition, I analyze 94 cases of court-ordered restitution and private settlements.

There are some limitations in the PIC data. First, cases where cartels rig bids against government-agency buyers must be identified through a reading of decisions of the antitrust authorities themselves (or reliable press reports of same). This split is normally clear, but some cartels require judgment. Second, the value of penalties is almost always known with certainty, but affected sales usually must be inferred from decisions or computed from industry trade sources. Third, some government penalties may include restitution for its injured agency.

Government -Sector/Private-Sector Comparisons

Six figures display the results. Because these penalty/sales ratios are highly skewed, the median is a superior measure of central tendency to the mean, only the median will be discussed.

Figure 1 appears to show that the severity of fines for all 303 ratios appears to be identical whether the victim is the government itself or private buyers. However, when one digs into the various jurisdictions, aggregation will be shown to mask typically large differences in intensities between the two sets of buyers.

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[2] Investigations were closed without any announced sanctions, mostly because of insufficient evidence of a serious violation, and all private compensatory actions were dismissed.

[3] The large majority of cartels have six or fewer corporate members. Moreover, some participants in a given cartel were convicted by one jurisdiction while a different, usually partially overlapping set of firms were convicted by a second jurisdiction.

In Figure 2, U.S. government fines are a striking *nine times higher* for government-sector bid rigging than for cartels that sold to private buyers. Cartels with severe penalties include international freight forwarders (directed at military shipments of household goods), heavy-lift ocean transport services (the U.S. Navy), and a large number of prosecutions in the E-Rate Program for school computerization. The Canadian Bureau of Competition appears to follow a similar policy of imposing harsher penalties on perpetrators of bid-rigging of government-sector purchases (Figure 3).[4]

In the EU, both the European Commission (EC) and the National Competition Authorities (NCAs) of its Member States impose heavier median fines on sellers that rig government tenders than cartel fines on all other sellers (Figures 4 and 5, respectively). In the case of the EC, the premium for collusion against government institutions is only 32%, but this is significant as the EC's rather detailed cartel-fining guidelines contain no language suggesting that this is a policy. Until late 2008, the EC had no authority to seek cartel damages on its own purchases; last year it instituted a damages action in a Belgian court against providers of elevators and elevator-maintenance services in Commission-owned buildings.[5]

Among the EU NCAs, the severity of fines on cartels is on average rather low; however, the median fines on cartel participants involved in rigging government tenders is *more than three times* higher than the severity of fines on all other cartels (Figure 5). Notable cases include several instances of bid-rigging of pharmaceuticals and hospital supplies in Italy and Portugal. Italy has prosecuted seven such cases between 1997 and 2006. The Italian antitrust authority caught manufacturers of infant formula *twice* colluding in their bids to supply the national health system with this critical item for infant health. The first time that the Italian subsidiaries of Nestle, Danone, Heinz and Humana Milch were punished, their fines amounted to 4.0% of affected sales; on the second occasion, the fine was 11.8% of the government-supply contracts.[6] This anecdote illustrates a general trend in Italy's treatment of bid-rigging against its national health service: before 2000 the severity of fines was significantly lower than since 2000. In Portugal, a group of manufacturers that sold diabetes blood-testing strips to local government hospitals were also caught illegally colluding twice; the second fine imposed was €21 million, a record fines by this NCA and ten times higher than the first fine.[7]

Antitrust authorities outside of Europe also impose higher fines on public-sector bid rigging, but the difference is small – about 16% (Figure 6). A couple of noteworthy cases include bid rigging of contracts to supply fuel to the militaries of Japan and Korea.

Finally, the PICs data includes eight cases of court-ordered restitution for procurement by government agencies. I find that the intensity of these quasi-private actions is nearly treble the intensity of all other private settlements (Figure 7). One well publicized example is a civil settlement by England's National Health Service against several manufacturers of generic drugs.[8] The Office of Fair Trading lost

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[4] However, there are only two government-bid-rigging observations, both involving sales of chemicals to the federal forest service.

[5] Ironically, the *Elevators* global cartel is not classified as "primarily government-targeted bid rigging" in this paper's sample, because the vast majority of affected sales occurred in the private sector.

[6] In the first round of fines, Abbott Labs was liable, but during the second episode of bid rigging, Abbott's subsidiary had dropped out of the running.

[7] The second episode appears to have covered more hospital tenders with a larger affected sales.

[8] The Scottish health service is suing separately.

an important criminal law suit, which was appealed all the way to the Law Lords, because the UK's new criminal antitrust statute had not yet been implemented prior to the collusion. Yet the fact is that the civil settlements were much more severe than the average fines imposed in Europe generally.

Conclusions

This note is a quick first look at a previously unexplored detail in the imposition of government antitrust penalties. At most, these patterns are merely suggestive of an empirical regularity that begs for further, more sophisticated multivariate analysis.

There may be alternative explanations. Perhaps, for example, the fact that governments take great offense at collusion directed at its own agencies is merely part of a more general practice of penalizing bid rigging in general. This is what Figure 8 seems to suggest. Perhaps antitrust enforcers are imposing more severe fines on corporate cartelists to signal their displeasure at the involvement of supportive third parties, such as trade associations or consulting firms. Figure 8 incorporates information on 49 cartels that had significant involvement by such third parties. Bid rigging with third-party involvement is treated much more severely than with no third party. These third parties are seldom fined, and the fines are merely token ones.[9]

While this first foray into government-sector bid rigging is hardly definitive, the results so far appear consistent with public choice theory. Trust busters seem to take bid rigging against their governments personally.
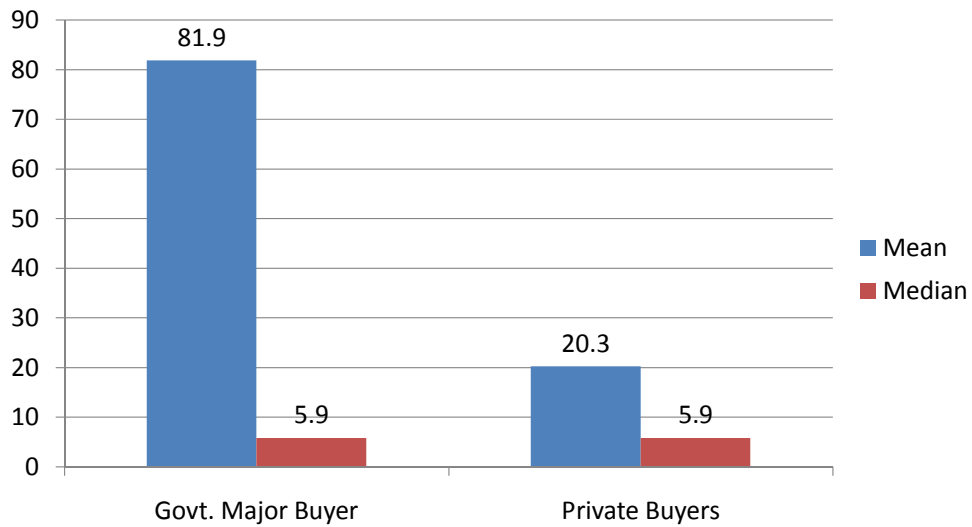
References

Tullock, Gordon. Public Choice, in pp. 1040-1044 of *The New Palgrave Dictionary of Economics: Vol. 3,* edited by John Eatwell, *et al.* London: Macmillan (1987).

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[9] The EC has imposed several such fines of €1000.

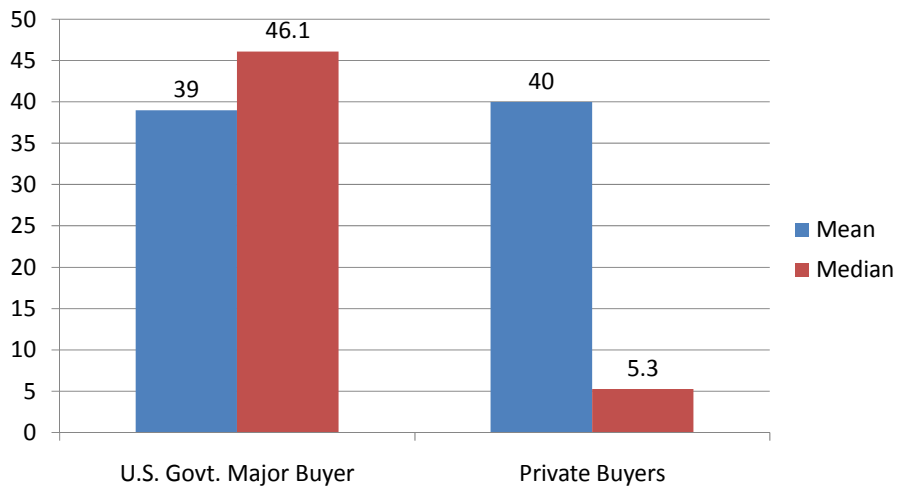**FIGURES**

1. Severity of Total Penalties by Type of Buyer

2. Severity of U.S. Fines by Type of Buyer

3. Severity of Canadian Fines
by Type of Buyer

4. Severity of EC Fines
by Type of Buyer

5. Severity of EU NCA Fines
by Type of Buyer
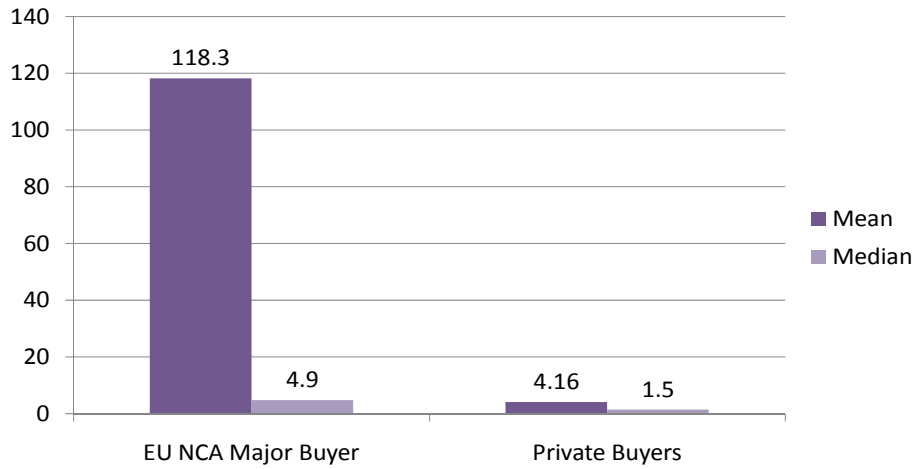
6. Severity of Other Nations' Fines
by Type of Buyer
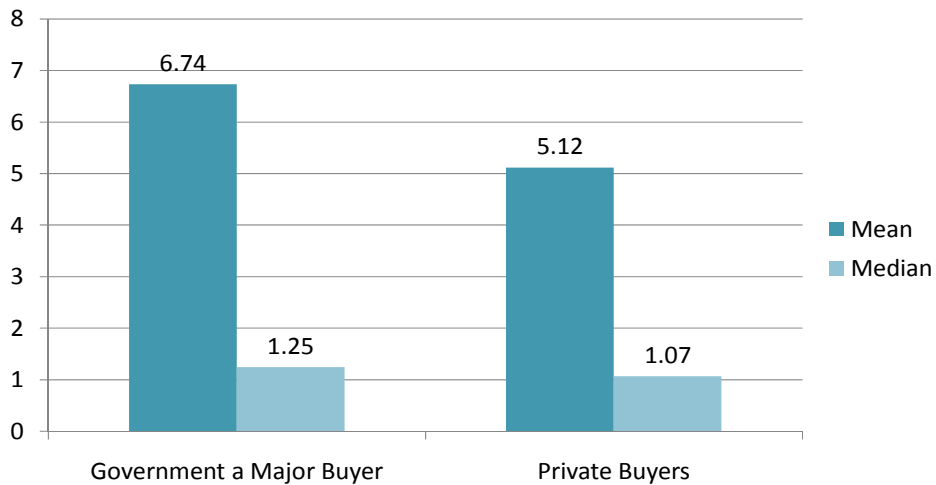
7. Severity of Private Settlements by Type of Buyer
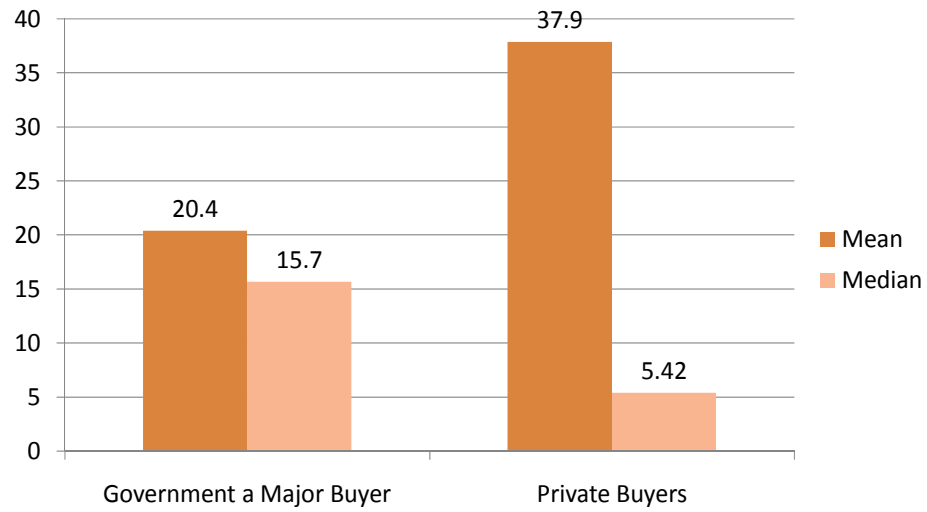
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8. Severity of Total Penalties by Type of Pricing Conduct