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Cartel deterrence in Russia: lessons to be learned



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The challenge



∞ To provide higher level of cartels deterrence without (significant) harm of socially desirable cooperation of market players

Issues



- ∞ Types I & II errors in cartels deterrence
- ∞ Cartel economics vs. effects of the cartel
- ∞ Pipes cases
- ∞ Caustic soda case
- ∞ Lessons



Types I & II errors in cartel deterrence

Types I & II errors in cartels investigation: the concept



- ❧ **Type I error** – «false positives»: qualification of economic entities as a cartel in case of cartel and other competition restricting agreements absence (strong form)
- ❧ **Type II error** – «false negatives»: there is cartel while qualification of the cartel (and other agreements restricting competition) is absent (strong form)

Consequences of type II errors: **external economics of cartel**

Connor, 2007; Connor, Helmers, 2007; Connor, Lande, 2005



- ⌘ Higher prices as compared with prices under competition (ceteris paribus);
- ⌘ Less physical exchange volumes as compared with competition conditions;
- ⌘ Less consumers surplus;
- ⌘ Higher seller profits as compared with competition;
- ⌘ Deadweight losses;
- ⌘ Innovations inhibition (dynamic aspect) in terms of cost dynamics and quality (useful goods dimensions).



Gary Becker (1968, 1974) = Punitive sanctions with moderate cost of cartel verification for antimonopoly agency (low probability)?...

Types I & II errors in cartels investigation: consequences

Polinsky, Shavell, 1989; Garoupa, Rizolli, 2012; Joskow, 2002; Avdasheva, Kruchkova, 2013, Png, 1986; Shastitko, 2011, 2013



- ❧ Weakening deterrence effect both due to type I error and type II one and/or over-insurance (L&E literature).
- ❧ One probable special effect of the type I error: removal of socially efficient activity to other markets, industries or jurisdictions (L&E literature)
- ❧ Another one - competition restrictions (“cobra effect”)



Cartel economics vs. effects of the cartel

Cartel markers

Christie, Schultz, 1995; Harrington, 2006; Jiménez, Perdiguero, 2011



- ☞ Price rigidity
- ☞ Spread formation regularities (stock market)
- ☞ Product standartization
- ☞ Increased uniformity across firms in product prices for product, ancillary services and quality
- ☞ Parallel behavior
- ☞ Meetings (industrial associations)
- ☞ Etc...

**Caution: Cartel may express its activity in some verifiable forms.
But identification of these form is not sufficient to prove the
cartel presence.**

Internal cartel economics: warning



- ❧ Cartel as a horizontal arrangement is not a cheap talk
- ❧ Recognition of the economic entity in the conspiracy
 - ❧ self-incrimination (Avdasheva, Shastitko, 2011),
 - ❧ misunderstanding of the meaning of the term (Zhang X., Zhang V, 2012; Huang, Zhang, 2010),
 - ❧ the desire to mitigate (avoid) punishment = sufficient condition for the establishment of the existence of a cartel? (matching with antitrust agencies incentives)

Internal cartel economics: literature



- ☞ Harrington, 2006
- ☞ Harrington, Skrzypacz, 2007
- ☞ Genesove, Mullin, 2001
- ☞ Hyytinen, Steen, Toivanen, 2012
- ☞ Cayseeley, Miegielsen, 2012
- ☞ Mouraviev, 2013...

No clear general theoretical framework for analysis of the cartel internal economy in terms of contracts and mechanisms of governance to interpret “hard” evidence...

Internal cartel economics: hybrid institutional arrangements



- ❧ Cartel is not only PROMISES of economic entities each other but also COERCION and ADAPTATION mechanisms
- ❧ Why COERCION? Usually, conditions for collective profit maximization are not equivalent to conditions of individual profit maximization
- ❧ Why ADAPTATION? Incomplete contracts and substitution of coercion for adaptation due to cartel illegality

Cartel agreements enforcement



- ❧ **Coercion** to abide condition of cartel agreement requires (1) diverse sanctions for violation, (2) system of monitoring to identify violation, (3) incentives to impose sanction in case of deviation discovered
- ❧ **Adaptation** mechanism under changing circumstances: (1) instruments (quotas, prices, quality standards), (2) specialized system of information disclosure based in communication
- ❧ **Substitutability of coercion for adaptation**

Sources of type I errors in Russian case



- ❧ The content of article 4 of the law on Competition Protection as regards the concept «agreement» (singular vs. composite)
- ❧ Standards of proof from facts findings perspective (guidelines and regime of access)
- ❧ Based on complaints administrative system performance with weak filter
- ❧ Discussion of particular issues of rules enactment and enforcement without sufficient awareness of the interplay with other ones

Hostility tradition in antitrust...



«One important result of this preoccupation with the monopoly problem is that if an economist finds something – a business practice of one sort or other – that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be rather large, and the reliance on a monopoly explanation, frequent»

Ronald Coase, 1972

...in details



1. Focus: level of market concentration and entry barriers.
2. Easy antitrust enforcement without taking into account of estimates of cases from welfare perspective based on all relevant and meaningful information.
3. Belief that collusion is easily created and enforced.
4. Entry barriers are anticompetitive and antisocial phenomena
5. The firm is adequately described as production function with purpose to maximize profit



Pipes cases: not realized
false positive

«Pipes case(s) 2011-2013»: FAS initial interpretation



- Relevant markets (single-joint longitudinally welded pipes, double-seam longitudinally welded pipes, or spiral-welded pipes) are concentrated.
- Significant entry barriers.
- High custom duties (15-20% as compared 5% for other products).
- Installed capacities exceed significantly consumption by Russian consumers
- Restricted access to transport infrastructure and stripe material.
- Schedules of LDP delivery signed by producers and...
Gazprom

«Pipes Case 2011-2013»: economic reconstruction



- ❧ Collusion under entrance?
- ❧ Collusion with large consumer participation?
- ❧ Credible commitment issues. Temporal specificity
- ❧ Indicative planning
- ❧ LDP producers' insurance (in economic sense) under mismatching of tender procedures on the one hand, and particularities of LDP and strip material production and supply, on the other hand

«Pipes Case 2011-2013»: output and outcome



- ❧ Requalification from clause 3 part 1 article 11 law on Competition Protection to part 4 article 11 of the given law
- ❧ Use condition of article 13 of the law to release all LDP producers
- ❧ However, there are some questions to be answered...
 - ❧ Industrial policy vs. Competition policy
 - ❧ The large buyer role
 - ❧ The role of «intermediator»
 - ❧ Influence of tenders frequency and lots volumes on competition
 - ❧ ...Limits of acceptable actions and interactions



Caustic soda case: hard
core cartel?

«Caustic soda 2011-...»: brief description



- ∞ The market of liquid caustic soda
- ∞ More than 20 economic entities
- ∞ Price maintaining, market division, contracting refusal (cl. 1,3, 4, part 1, art 11)?
- ∞ Transport expenses (logistic schemes)
- ∞ Internal price vs. export price
- ∞ Financial result of export

«Caustic soda 2011-...»: important dimensions to take into account



- ❧ Strong complementarity of two products – caustic soda and chlorine on primary resource (brine)
- ❧ Products with high risk of storage and transportation (especially chlorine)
- ❧ Short period of chlorine storage (≤ 72 hours),
- ❧ Dramatic differences in demand for two products dynamics,
- ❧ Production capacities allocation as compared with consuming capacities
- ❧ Three technologies of production
- ❧ Product differentiation (horizontally and vertically).

Lessons to be learned ...



- ❧ Do not confuse cartel effects with economics of cartels as an agreement
- ❧ Cartel investigation has to provide evidence in the following aspects
 - Cartel markers (as a condition for case opening but not sufficient proof)
 - Understanding of contracting in the industry
 - Identification of economic meaning of the agreement
 - Description and explanation of enforcement mechanism both on the side of coercion and adaptation
- ❧ Remember history of hostility tradition in antitrust to avoid deterrence failure



In details:

Shastitko A. Cartels: incentives,
organisation, deterrence policy //
Russian Journal of Management, 2013,
Volume 11, №3, p.31-56 (in Russian)



Thank you for attention!

www.lccp.econ.msu.ru