

Choice of the Law Enforcement Model: On the Example of Consumer Protection, Labor Regulation and Antitrust Legislation in Russia



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Reasons for the Research I



- ❧ Two major problems of civil law enforcement in Russia are:
 - ❧ Excessive costs of administrative control and supervision
 - ❧ Insufficient deterrence
- ❧ Standard police recipes to solve the problems are:
 - ❧ Shift from regular to reactive (based on victim's complaints) model of administrative supervision
 - ❧ Increase of penalties
 - ❧ We doubt that there are good solutions
 - ❧ One specific problem is that innocents bear the burden of administrative control as well as the burden of enforcement errors
 - ❧ But the burden on innocents is almost not taken into account
 - ❧ As well as consequences of opportunistic complaints

Reasons for the Research II:



- ❧ I. Effects of Type I errors (punishment of the innocents)
 - ❧ Legal errors are studied within the given model of enforcement (Calfee and Craswell, 1984, 1986; Kahan, 1989; Grady, 1989; Poilinsky and Shavell, 2007) but not compared across different models of enforcement.
- ❧ II. Models of enforcement compared are predominantly private and public enforcement (Landes and Posner, 1975; Posner, 1992; Polinsky, 1980; Garoupa, 1997; Shleifer and Hay, 1998; Segal and Whinston, 2006; Pham, 1996; Armour et al. 2009; Roe and Jackson, 2009).
 - ❧ Public enforcement upon individual complaints (selective public enforcement) is rarely considered as a distinct model
- ❧ III. Impact of individual choice on the evolution of enforcement model

Goals of the Paper



- To compare determinants of enforcement errors under the three alternative enforcement models – the ‘pure’ public enforcement, the ‘selective’ public enforcement and the private enforcement
- To explain individual choice between the private and selective public enforcement and impact of the private choice on the deterrence effect
- To illustrate theoretical conclusions by the three areas of legislation in Russia: consumer protection law, labor law and antitrust law

'Selective' (or 'reactive') public enforcement in contrast of private and 'pure' public

'Pure' Public Enforcement

A Regulator carries out inspections

if violation is detected penalties are imposed on the Offender

Selective Public Enforcement

the Victim applies to the Regulator

A Regulator carries out inspections

if violation is detected penalties are imposed on the Offender

Private enforcement

the Victim files a suit to the Court

if the Court decide for the plaintiff the Offender is to pay compensation to the Victim

*Can selective public enforcement replicate **advantages** of both types of enforcement (McAfee, 2005) or **drawbacks** of them?*

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Type I Errors and Deterrence



Following Becker (1974), deterrence effect arises when

$$qA + (1 - q)(A - F) \geq p(A + Y - F) + (1 - p)(A + Y)$$

$$Y \leq (p - (1 - q))F$$

A - gains when acting legally,

Y - additional gains from the offence,

F - amount of penalty,

p - probability of sanctions on the violator,

q - probability of non-imposition of sanctions on the innocent

$1 - p$ - probability of Type II errors

$1 - q$ - probability of Type I errors

Determinants of Deterrence under Different Types of Enforcement

	'Pure' public enforcement	Private enforcement	'Selective' public enforcement
	$F = const$	$F = F(Z)$	$F = const$
Determinants of Type II errors	$p_1 = p_1(r, e)$ $r = \frac{R}{O}$	$p_2 = p_2^a p_2^s$ $p_2^a = p_2^a(c, F, Z^f, E(p_2^s))$	$p_3 = p_3^a p_3^s$ $p_3^s = p_3^s(r, e)$; $r = \frac{R}{N}$; $N = (p_3^a + q_3^a)O$ $p_3^a = p_3^a(c^c, Z^f, E(p_3^s))$
Determinants of Type I errors	$q_1 = q_1(r, e)$	$(1 - q_2) = q_2^a q_2^s$ $q_2^a = q_2^a(c, F, Z^f, E(q_2^s))$	$q_3^a = q_3^a(c^c, Z^f, E(q_3^s))$; $q_3^s = q_3^s(r, e)$; $r = \frac{R}{N}$ $N = (p_3^a + q_3^a)O$

F - money equivalent of penalties; Z - money equivalent of damage; Z^f - money equivalent of future damage that could be prevented.

p - probability to punish the guilty person; q - probability not to punish innocent person;

r - resources of public authority to inspect one person subject to regulation R - overall amount of resources available to public authority; O - number of requirements subject to control.

e - efforts of public authorities to inspect ;

c - costs of litigation under private enforcement; c^c - costs of complaint under selective public enforcement;

p^a - probability of justified lawsuit (under private enforcement) or complaint to public authority (under selective public enforcement)

p^s - probability of satisfaction of justified lawsuit (under private enforcement) or complaint (under selective public enforcement); $E(p^s)$ - expected probability of satisfaction of justified lawsuit (under private enforcement) or complaint (under selective public enforcement)

q^a - probability of unjustified lawsuit (under private enforcement), or complaint (under selective public enforcement); q^s - probability of satisfaction of unjustified lawsuit (under private enforcement) or complaint (under selective public enforcement); $E(q^s)$ - expected probability of satisfaction of unjustified lawsuit (under private enforcement) or complaint (under selective public enforcement)

N - number of complaint to public authority under selective public enforcement.

Indexes correspond: 1 - to pure public enforcement; 2 - to private enforcement; 3 - to selective public enforcement.

Individual Choice between Enforcement Models

- ⌘ If the state allows to enforce legislation both privately and publicly, than the selective public enforcement is individually preferable if:
 - cost saving by filing a complaint to an authority instead of litigation exceeds the gains from the expected compensation for damage within the system of private enforcement
- ⌘ When selective public enforcement is individually preferable, outcomes of individual choices increase the number of complaints, decrease the resources available for each investigation and increase the probabilities of both Type I and Type II errors. **The deterrence effect decreases.**
- ⌘ Additionally, structure of enforcement is shifted towards cases initiated by the abusing complaints

Enforcement of the Consumer Law in Russia



- ⌘ 'Consumer-friendly' enforcement rules since 1992, including opportunities to solve the collective action problem
- ⌘ The private enforcement won the competition with the public one

	Public	Private
Total amount of cases	40,000	>200,000
Average compensation/penalty (USD)	>230	3000

- ⌘ over 85% of claims reviewed are being satisfied by courts
- ⌘ less than 1% of decisions are reversed by the appeal instances

Enforcement of the Labour Law in Russia



- ☞ The private enforcement won the competition with the public one

	Public	Private
Total amount of cases	183,000	860,000
Average penalty (compensation) (USD)	117	3500

- ☞ 92% of claims are being satisfied by the courts
- ☞ the proportion of decisions reversed by the appeal instances is less than 1%

Enforcement of Antitrust Legislation in Russia



No private litigations at all, in spite they are possible
Moreover, Supreme Arbitration Court RF issued special decision supporting private suits

The large and growing number of antitrust cases carried out by national competition authority Federal Antitrust Service (more than 2500 annually)

Introduction of turnover penalties and increase of fines collected were expected to increase the deterrence

However:

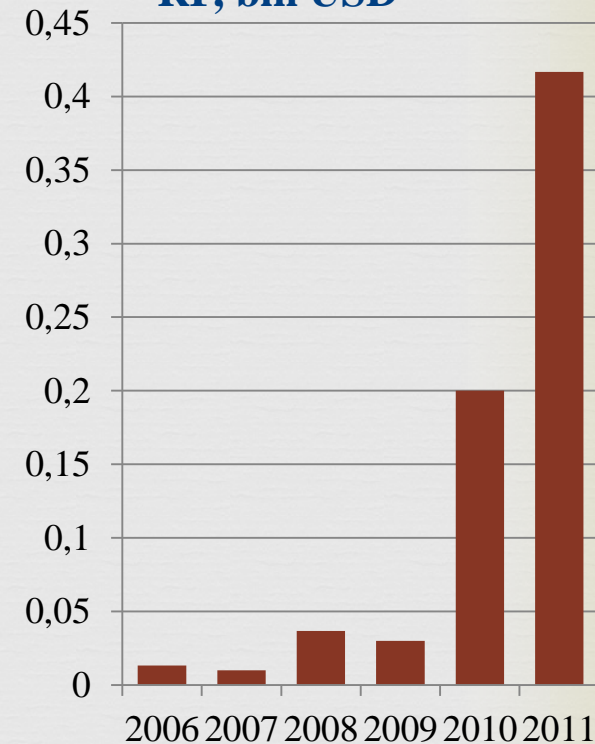
There is no evidence of improving the deterrence

Cases become more and more skewed towards exploitative practice (in contrast to restriction of competition itself)

About 40% of the decisions of FAS are reversed by the arbitration courts of first instance

Number of Type I errors is very high

**Fines for the violations
of antitrust legislation
RF, bln USD**



Why Antitrust Enforcement is So Different?



- ❧ The demand for enforcement increased, because of increasing ability to deter violations due to relatively substantial fines
- ❧ Selective public enforcement suppressed private one;
 - ❧ On the side of individual choice: the standards of compensation are very low
 - ❧ The ability to impose the investigation costs on the competition agency makes the selective enforcement individually preferable
 - ❧ The performance evaluation of the competition agency (Key Performance Indicators) supports the actions on direct complaints
- ❧ The main effect is the overenforcement, which is (traditionally) expected to be the outcome of private but not public enforcement

Conclusions



- ❧ The impact of Type I errors on deterrence and welfare effects of enforcement could be very high, especially in the countries with less developed traditions of legal actions and relatively poor standards of proof.
- ❧ The private enforcement has some sufficient comparative advantages. Moreover, it is easier to compensate the shortcomings of the private enforcement model than the public enforcement one.
- ❧ Under certain conditions selective enforcement model replicates shortcomings of both private and pure public enforcement model
 - ❧ Higher probability of both Type I and Type II errors due to decreasing resources on the investigation of the case
 - ❧ And therefore to lower the deterrence effect
 - ❧ Distortion of public enforcement towards violations inflicting substantial private instead of social losses
- ❧ But the selective public enforcement may be individually preferable.

Policy implications



- ❧ If Russian competition authority refused to consider the cases where damage is imposed but there is no evidence on the restrictions of competition in favor of private litigation
 - ❧ Number of errors (both Type I and Type II) would be lower
 - ❧ Deterrence effect of enforcement would be higher
 - ❧ Cost of compliance would be lower
- ❧ It is necessary to create additional incentives for the private litigations
- ❧ It is necessary to limit incentives for selective public enforcement at the expense of pure public one

Thank you very much



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