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To

Senate Committee on the Judiciary

Subcommittee on Antitrust, Competition Policy and Consumer Rights

On

“Cartel Prosecution: Stopping Price Fixers and Protecting Consumers”

Thursday, November 14, 2013

Thank you, Senator Klobuchar and other members of the Committee, for inviting me to speak to you today.

Cartels can and do have a significant negative impact on consumers and competition. My research with Valerie Suslow has shown that cartels do last – perhaps not forever – but on average 7-10 years, a duration that is comparable to the lifespan of the average U.S. business.¹ Cartels may fall apart, but not so quickly that we can ignore the very real impact that they have on consumers and competition. While economists, being economists, differ on exact estimates of the impact of cartels on product pricing, it is clear that cartels, where successful, can raise

prices substantially. That they raise profits is clearly evidenced by the length firms go to in order to maintain collusion despite the penalties for doing so.

Cartels do not simply harm consumers by increasing prices. To survive, cartels must prevent other firms from taking advantage of the profit opportunity created by high prices. When prices and profits are high, other firms will attempt to enter the market. To survive and protect their profits, cartels must create barriers to entry. Some of these barriers to entry will not endure over time. But if you are a firm who attempts to enter an industry and is denied access to technology, as happened to a firm in the graphite electrodes cartel, or denied access to customers, as happened to a manufacturer of sewing needles, or faced with a targeted price war, as a firm trying to sell steel pipe was, then your impact on the market will be stymied and the cartel’s price will be maintained. It won’t matter to you that some other firm, perhaps with deeper pockets, manages to wear the cartel down some years later.

The Antitrust Division of the U.S. Justice Department has had a consistent and strong anti-cartel enforcement policy for the last twenty years. But we continue to discover a steady stream of cartels, including cartels that have formed since the adoption of more consistent and aggressive

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amnesty and leniency policies. And we see recidivism – firms that are caught and fined and should have learned better, who are caught again.4

This suggests that existing penalties are not yet sufficient to deter collusion.5 Fines that are large enough to deter collusion are probably so large that they would bankrupt firms, undermining rather than strengthening competition. This is especially true given the profitability of collusion and the uncertainty of detection. Large fines are important, as large fines are what get shareholders’ pocketbooks and attention. Firm owners must fear prosecution if they are to have the incentive to establish appropriate corporate governance that includes rigorous internal antitrust compliance policies. But we need smarter, not simply larger, penalties. The Division’s policy of using jail terms provides a much more effective deterrent to the individual executives and managers who are active players in the cartel. Two other potential remedies that have been used less and that should be used more are: (1) regulation or prohibition of future activities in the industry by convicted executives who have shown themselves willing and able to participate in criminal activity against consumers6, and (2) increased scrutiny of mergers and acquisitions by firms that have been involved in collusive activity. We do not want to break up a cartel only to allow the industry to reorganize and consolidate, simply creating a merged firm as a more durable cartel form.7

7 See, for example, a speech by FTC Commissioner J. Thomas Rosch: “A similar issue arises when a former cartel member enters bankruptcy proceedings. The priority of bankruptcy courts is to take actions that preserve the value of the firm’s assets to its debtors. This presumption can lead to anticompetitive industry reorganization. The DOJ and the FTC have intervened in bankruptcy proceedings with mixed success. For example, in the aftermath of
It is important to remember that while private, civil action increases the financial penalties resulting from collusion beyond what criminal fines can do, private action is limited in its ability to deter collusion for two reasons. First, as I have said, there is a limit on the size that fines can reach before they become counter-productive. More importantly, private action, by itself, rarely discovers new cartels or instances of collusive behavior. Private citizens and companies do not have the same investigative and discovery tools as the U.S. government. Civil actions can reinstate fairness for consumers, but it is extremely unlikely that small customers are going to discover that they are the victim of collusion through civil action. Thus, civil penalties for private actions are a useful complement to effective enforcement – working side-by-side with criminal enforcement – but such penalties are not a substitute.

The Antitrust Division’s use of amnesty and leniency for the first firm who confesses to participation in a cartel and provides evidence against the cartel has been highly effective at identifying and ending a large number of cartels, particularly international cartels that had previously considered themselves outside the scope of enforcement. These prosecutions are important in that they highlight the continuing, and often strikingly blatant, anticompetitive conduct that was considered normal business practice. Cartels have been found in many different products and they affect consumers in industry, agriculture, financial services, and the

the prosecutions related to the graphite electrodes cartel, the Carbide/Graphite Group filed for Chapter 11 bankruptcy protection. The DOJ filed an antitrust lawsuit to prevent SGL, a co-conspirator in the cartel, from acquiring Carbide/Graphite Group. The bankruptcy court judge awarded the assets of Carbide/Graphite Group to another company and the DOJ dismissed its lawsuit. In a more recent case that did not involve prior collusion, the FTC was unable to convince a bankruptcy judge to slow the march of bankruptcy proceedings sufficiently to protect the interests of consumers.” “Implications of the Financial Meltdown for the FTC” quoted in Levenstein and Suslow, “Constant Vigilance: Maintaining Cartel Deterrence During the Great Recession,” Competition Policy International, 6: 2, Autumn 2010, p. 154.
public sector. These cartels have been found in a wide variety of industries, including ones that are technologically dynamic, like computer chips and flat panel screens. Technological dynamism does not make an industry immune to collusion.

The very success of the Division’s antitrust and leniency policies creates another issue. Amnesty and leniency cases still require resources. Unless resources for effective prosecution are expanded, amnesty and leniency cases can crowd out the resource-intensive investigations that are necessary for discovering cartels. There is a lot of money at stake for colluding firms, so it is worth it to firms to try to hide what they are doing and to develop new and evermore sophisticated ways of doing so. That means it takes real resources on the part of investigators to discover collusion.

There are things that investigators can do besides wait for confessions or calls from whistleblowers. We have made important advances in using statistical techniques to identify collusive activity. These screening techniques highlighted the high likelihood that LIBOR rates were being set collusively three years before the nature of the activity of participating banks was reported by the Wall Street Journal. Novel techniques in scraping the web and analyzing web-based communication could be used to discover “invitations to collude” such as those that were at the center of the U-Haul case. Intra-industry swaps, which have legitimate business applications.

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9 “[I]n response to U-Haul’s actions from 2006 through 2008 to raise market prices, including announcements made during a 2008 quarterly earnings conference call, the FTC and U-Haul agreed that U-Haul would refrain from `[c]ommunicating, publicly or privately, to any Person who is not an Insider, that Respondents are ready or willing . . . to raise, fix, maintain, or stabilize prices or price levels, rates or rate levels, conditional upon a Competitor also raising, fixing, maintaining, or stabilizing prices or price levels, rates or rate levels.’” Competition Policy International 2010, p. 152.
purposes but which are also used by cartels to adjust output to meet cartel quotas, could be investigated. There are activities which we know cartels use to sustain collusion and hide collusion. With suitable resources the Division (or the FTC) could detect these activities and determine when they are being used to undermine competition.

The Division and the FTC could and should put also resources into identifying highly concentrated market niches. Many of the cartels that have been discovered in the last twenty years operate in markets that are extremely concentrated. In one study, we found that over two thirds of cartels were in markets with a four-firm concentration ratio of over 75%. Cartels do form in less concentrated industries, and certainly there are pro-competitive reasons for large and concentrated industries. But with appropriate resources, the DOJ and FTC can identify markets that are potentially at risk. This is not necessarily a simple or obvious task, as market definition is key. For example, there are over 5600 commercial banks in the U.S., and for decades most economists have insisted that the United States suffered from too much fragmentation, not too much concentration, in banking. Hence, deregulation to allow interstate banking, etc. But the number of participants in LIBOR is much smaller. The number participating in the foreign exchange markets is smaller. I can count on one hand the number underwriting municipal bonds. There’s a reason that Professor Suslow and I called a recent paper “Constant Vigilance.”

Finally, outreach to potential victims, including giving them advice on how to detect and prevent bid rigging as was done for public procurement funded under American Reinvestment and Recovery Act and as the Division does to the extent possible, brings the resources of a

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much larger number of people – and people with an interest in paying attention – to bear on the discovery of collusive and anticompetitive activity.

While we may never stop all price fixing, there are both investigative tools and sanctions that, with appropriate policies and resources, we can apply to reduce the impact of anti-competitive behavior on consumers and competition.