

# Competition and the cartel crusade

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At the heart of the *Trade Practices Act* is Section 45. Over some 20 pages, this section explains the illegality of businesses conspiring to fix prices or otherwise diminish competition in a market. Issues concerning combines, or cartels of firms which avoid competing with each other and share the market, have been brought to prominence in Australia with the acknowledgement by Visy and Amcor that such agreements had been made and were current, at least between 2000 and 2002. This has given new impetus to the role of the Australian Competition and Consumer Commission (ACCC) in uncovering such agreements.

A phrase of Adam Smith's is frequently the starting point for people favouring government control over cartels. Smith maintained that, 'People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.' What those invoking Smith's authority rarely point out is that Smith went on to counsel against intervention by the authorities, saying: 'In a free trade an effectual combination cannot be established but by the unanimous consent of every single trader, and it cannot last longer than every single trader continues of the same mind.'

Over the past century, the existence of suppliers' market power, its endurance and the appropriate role for government in controlling it have been major issues for economic and political analysts.

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Legal measures to control or prevent monopoly come under the title 'antitrust', an American term dating from the nineteenth century for laws that originally targeted firms such as the successful Standard Oil enterprise built up by John D. Rockefeller. In fact, Standard Oil was by no means the ruthless price-boosting monopoly that has been depicted. Its share of refining capacity was under pressure from major rivals

targets of this regulatory aggression.

It is argued with some cogency that individual firms that have achieved market domination bring benefits involving economies of scale that are far less likely in the case of market domination by inter-firm agreements. Cartels are, accordingly, lacking an important attribute that an individual monopolist might have. Cartel agreements are of greatest importance in Australia where there is

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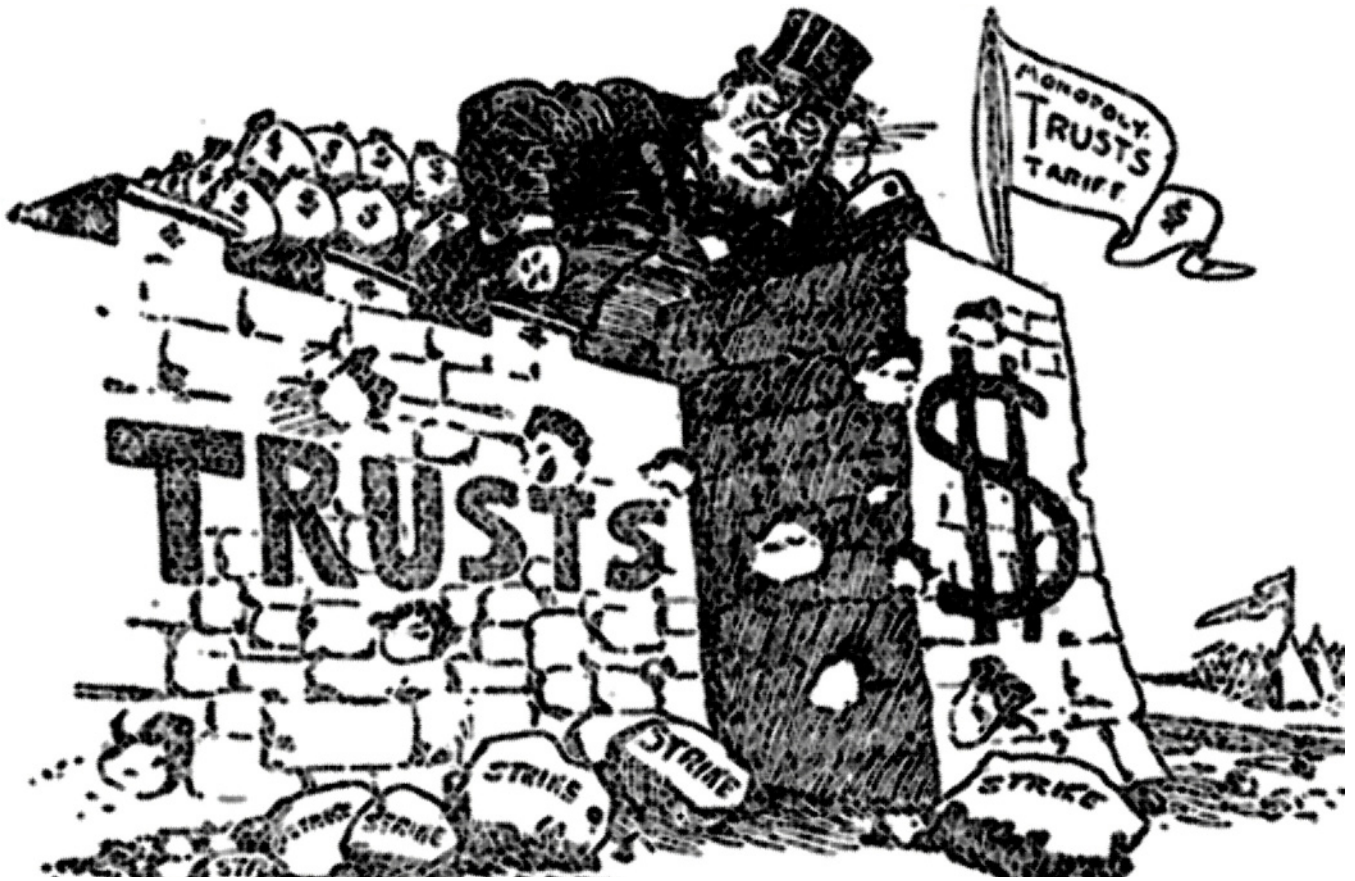
such as Shell and Texaco and it fell from 82 per cent in 1899 to 64 per cent at the time of its break-up in 1911. Prices of kerosene (the main petroleum product) fell precipitously during the period of Standard Oil's industry domination.

Standard Oil was not the last firm to come under unjustified regulatory attack. Many high profile businesses are now seen as having been ludicrously targeted in light of the obvious lack of market power that was revealed by commercial processes. Modern-day victims of the regulatory agencies have included large firms, for example, GM and IBM, both of which faced years of scrutiny and legal action before claims about their monopolistic abuse collapsed in the face of market positions that had crumbled under the weight of competition. Microsoft and Google are now the

no provision to break up a dominant firm once it has reached such a market position (although there is provision to prevent that being achieved through takeover activity).

Economic analysis of cartel issues tends to fall within two schools. Legal authorities such as the ACCC and many economists maintain that there is a great deal of collusion taking place and that prices across many product areas are much higher as a result. In this respect, one writer in the *Australian Financial Review* this year (13 October) reported the current Chairman of the ACCC to have said, 'If I can find an industry where they were not involved in, I will tell you.'

Others are sceptical. They argue that some unique circumstances are required for a cartel to hold together. Among



Detail from unionist cartoon in *New York American*, November 1, 1904, exhorting union members to vote for anti-trust politicians after the failure of industrial action.

these is an inability of firms outside the cartel (attracted by the high prices and profits that the cartel is creating) to enter the market. Such entry undermines the cartel and forces its collapse. Of course, where such entry is forbidden and the cartel enjoys other support from government, as was the case in the long-standing Australian domestic airline cartel, its existence can be enduring. Even where entry is difficult—because, for example, it requires some scale economies and the building of a reputation—cartels will often be vulnerable because the partner firms are likely to have different costs and marketing aspirations and will frequently cheat on each other.

The most comprehensive studies of cartels have been conducted at Purdue University by John Connor and his associates. In a 2005 paper, 'Price-Fixing Overcharges', Connor examined data on 237 cartelised international markets covering 512 episodes. From this meta-analysis he

estimated that overcharging was 25-30 per cent on average (one study he drew from conducted by the OECD may have been more rigorous, but still put the level at 15 per cent).

Connor believes that cartels are pervasive and he is generally in favour of more vigorous government intervention to enforce competition. His analysis does not attempt to estimate the longevity of the price distortion of the cartels—although it does suggest that some persisted for decades. Moreover, the counterfactual is not easy to assemble. How do we judge what the excessive price has been? Often industries that are relatively concentrated (as is almost mandatory for those where firms can agree to subdue their inter-firm rivalry) see some price volatility as competitors jostle for market share. After an agreement has collapsed, a spate of price-cutting would be expected and prices can fall to marginal costs (and below) for certain periods.

In this respect, analysis is made more difficult because economics has never provided a useful guide on how prices are actually set. Marginal costs are sometimes used to define where firms should offer product, but this cannot be useful as a price determinant except as a possible price floor in cases where the market is highly over-supplied. Thus, nobody would claim that cartelisation occurs in the car market, yet cars, which embody a high fixed-cost component, normally sell for at least twice their marginal costs.

Connor makes some curious statements in his analysis. For example, he argues that if cartels are charging a price sufficient to allow the highest cost member to be profitable, this proves that all others are making 'economic profits' and overcharging. In fact a dispersion of costs across an industry is almost inevitable, with some firms earning far more than others. Even in highly disaggregated

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supply cases such as wheat, at any given world price, the most marginal suppliers are likely to be barely profitable, while some suppliers will earn high profits.

No piece of work has attempted to analyse these cases from the sceptical perspective. The issue for most of those who are wary of government involvement is the degree to which cartels actually boost prices above competitive market levels. Dominick T. Armentano, in his 1986 monograph *Antitrust Policy: The Case for Repeal*, appears to favour no law restricting cartels, but this would mean no restraint on measures like sellers' rings parcelling up contracts in areas where few suppliers are qualified. At the very least, the absence of legal constraint on firms striking anti-competitive agreements would mean more of them would exist and they would have far more potent effects if the next logical step were to be made—namely, allowing such agreements to be judicially enforceable.

There are those who argue that, instead of agreements on price being disallowed per se, the 'rule of reason' should apply to all such agreements. While provision is available for the ACCC to allow agreements, this must be subject to considerable prior analysis and be open to scrutiny. No such agreements have been registered in recent years.

Shipping conferences—associations of shipping firms to set rates and schedules—are one sort of cartel that many consider to be benevolent, although this was not a view shared by the ACCC or by a recent Productivity Commission report. They are covered by specific provisions (Part X) in the *Trade Practices Act*. Many shipping conferences simply attempt to coordinate sailings in such a way that frequency and reliability is

facilitated and, as such, are clearly pro-consumer. Others attempt to fix rates and share the market, but none of these endure—the different costs, rivalry and the ability of non-conference competition to poach trade ensures that such measures cannot diverge from market rates for very long. By and large, Australian governments have taken the view that trying to prevent these attempts at market-sharing would undermine other advantages that the Conferences bring in terms of greater frequency and reliability of sailings, coordination and risk-sharing.

The invariable instability observed with shipping cartels was also seen in the Visy/Amcor agreement. Visy used the agreement to shed unwanted customers (those that were seasonal and unprofitable for other reasons) while chiselling away at the more valuable elements of Amcor's customer base. During the course of the agreement, Visy's market share grew from roughly 50/50 to 55/45, with Amcor's share bolstered by being burdened by the less valuable customers.

Neither price falls nor major shifts in market shares are characteristic of traditionally described cartels. If, as seems to be the case, the agreement largely clouded a different form of competition through which Visy continued to attack those of Amcor's markets that it valued, does this constitute an agreement to defraud the public? It is by no means illegitimate for firms (or political parties or football teams for that matter) to deceive their competitors. Indeed, secrecy and deception are major parts of the competitive armoury.

The issues therefore revolve around the following questions:

- Are there cases where cartels may proffer advantages as are generally accepted by most governments in the case of shipping conferences, some of which also have price agreements?
- Should it be illegal to offer to enter into price/production agreements even if there is no intent to abide by them?
- If agreements are as widespread as are asserted by the ACCC Chairman, should there be a major increase in funding for regulatory agencies to combat them? (While this is doubtless a view of the agencies themselves, they are not disinterested parties. Furthermore, increased activity and funding by regulatory agencies is likely to bring about the sort of misplaced aggression that has been seen in the US and in Australia where, for example, the ACCC has used imaginary data when trying to pursue cases against petrol retailers.)

Finally, those who believe that cartelisation is widespread need to identify just how great the detrimental effects have been. There is no evidence that the industries that are alleged to be prone to cartelisation have experienced lower productivity or that their customers have been markedly disadvantaged. Moreover, if the level of cartelisation has been and remains pervasive, this does not appear to have been accompanied by lower levels of productivity for economies as a whole.

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