

Well-dressed thieves

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Why the threat of prison is necessary to deter cartels

GRIMSBY lies on the Humber estuary on England's east coast. It is an unlikely location for a landmark white-collar crime. The town, which once had a thriving sea-fishing industry, last troubled the business pages three years ago when Unilever, a food company, announced that it was closing its fish-finger factory there. Yet next month three executives, two of them former employees of Dunlop Oil and Marine based in Grimsby, go on trial in Britain for their role in a global price-fixing cartel.

The three have already pleaded guilty in America to their part in a conspiracy that carved up the market for marine hose—used to funnel oil from tankers to storage facilities. The defendants face jail under the terms of a plea-bargain with American prosecutors. Time served in British prisons will be knocked off the sentences handed down in America.

The British trial is the first under new powers granted in 2003 and reflects a harder line against price-fixing throughout the rich world. Cartels have long been prohibited, but many countries have recently adopted criminal sanctions. Conspiring to rig markets is punishable by prison in Germany, France, Ireland, Japan and Canada, as well as America and Britain. Australia is about to join the club too. Its new government, led by Kevin Rudd, confirmed last month that it would make cartels face jail.

What explains the clamour for harsher penalties? After all, other sins against competition are usually dealt with by an order to desist or a fine. When European Union courts upheld the case against Microsoft for abuse of its dominant position last year, the firm had to fork out a hefty €777m (\$990m). But Steve Ballmer, the software giant's CEO, was never threatened with prison.

That is just as well. Antitrust breaches such as the ones that Microsoft was convicted of—using its monopoly in desktop operating systems to hinder rivals in related markets—are hard to distinguish from robust competition. One of the firm's misdeeds was to bundle its media player with Windows. Yet bundling is a common business practice that can be entirely legitimate. Every greasy-spoon café bundles its eggs, bacon and sausages on to a plate that is sold for less than the sum of the constituent parts.

It is often tricky to draw the line between healthy discounting and predatory pricing too. Loyalty discounts are widely used in business and have benefits for consumers and suppliers alike. But such schemes can be used nefariously to keep rivals out of a market and preserve an incumbent's monopoly. In cases such as these, it is hard to say for sure whether firms' actions are harmful to consumers. The immediate benefits of lower prices have to be weighed against uncertain longer-term costs. Firms may be genuinely unclear on what is permissible and heavy sentencing may make them wary of competing aggressively.

There is no such risk of over-enforcement with cartels. For big and sophisticated firms, entering into an agreement to fix prices is a clear and knowing conspiracy against consumers. And because such pacts are secret and hard to uncover, harsher penalties are needed if the expected costs of price-fixing are to exceed the likely benefits. In principle, a big fine might suffice. But in practice a fine large enough to work as a deterrent would financially cripple a company, further impairing competition and harming innocent bystanders, such as suppliers and workers.

Sanctions against culpable executives ought to be more effective. Fining managers, however, has some of the same problems as fining firms. Because there is only a small chance of being caught, a penalty big enough to put off a budding price-fixer may be many times his wealth—and hence unpayable.

There is some evidence to suggest that the personal sanctions are a more effective deterrent than financial penalties. A survey carried out for Britain's Office of Fair Trading (OFT) asked executives to score the deterrent effect of five sanctions. Fines ranked fourth and private damages fifth, behind bad publicity and being disqualified from doing business. The most feared punishment was prison. In America trustbusters say that busted price-fixers regularly offer to pay bigger fines to try and avoid jail.

Waving a get-out-of-jail-free card

The threat of jail also helps with the detection of cartels. Trustbusters rely heavily on the promise of amnesties to crack price-fixing conspiracies. Immunity for whistleblowers strikes at the heart of a cartel, because each conspirator is aware one of the others could rat to the authorities and escape punishment. The harsher the penalty, the greater the spur to be first to confess.

Since penalties in America were strengthened in 2004 the caseload of cartel-busters has increased. At the end of the past fiscal year, there were 135 pending investigations, the highest since 1992. The OFT's own leniency policy was instrumental in breaking up a price-fixing deal on transatlantic flights between Virgin and British Airways (BA). Virgin spilt the beans; but only BA paid a fine. And though both companies agreed \$204m compensation with passengers on February 15th, a criminal investigation is still in progress and BA executives may yet go to jail.

In Australia Visy was fined A\$36m (\$32m) in November for fixing the price of cardboard. The case created a stir because of the record fine and because the judge said that every Australian had been harmed by the cartel each time they bought goods that had been moved in cardboard boxes.

Or to put it more bluntly: consumers were robbed. As Australia's chief trustbuster, Graeme Samuel, noted after the trial, "Cartels are theft—usually by well-dressed thieves". Attitudes towards white-collar crime have changed since the 1970s, when a senior American judge sentenced cartel members to giving lunchtime lectures on the evils of price-fixing. Today the belief that the punishment should fit the crime is gaining ground. Cosy deals with rivals, even perhaps ones hatched in unc cosy places such as Grimsby, are larceny and should be treated as such.