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COMPETITION COMMITTEE**

Global Forum on Competition

CRISIS CARTELS

-- Summary of Discussion --

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SUMMARY OF DISCUSSION

By the Secretariat

Organisation and opening remarks

1. Following remarks by the Chairman of the OECD Competition Committee and the Chairman of this session, this session was divided into four consecutive sections (on the historical lessons from crisis cartels, including the key matter of whether one approach to evaluating such cartels makes for sound policy; on crisis cartels and their relationship to the allocation of resources; on crisis cartels and price instability in developing countries, in particular for food and agricultural commodities; and on whether any trade-off between development considerations and efficiency justified resort to crisis cartels.) Five presentations were made by experts, followed by numerous illuminating interventions from governmental participants. Twenty-one contributions from official delegates were received by the Secretariat and were circulated in addition to three papers by experts and one background document.

2. **Mr. Frédéric Jenny, Chairman of the OECD Competition Committee**, began the session by describing some of the policy-relevant issues that would be discussed in session 3, namely, whether there was a justification for crisis cartels and the appropriate policy responses to such cartels, including potential competition advocacy efforts by competition authorities. Such advocacy, he noted, might highlight alternatives to crisis cartels by which a government could attain a known objective. Professor Jenny also introduced **Mr. Prem Narayan Parashar**, a member of the Competition Commission of India, who chaired this session.

3. The purpose of this session, remarked Mr. Parashar, was to examine whether the formation of cartels during economic crises can be justified. Although such crisis cartels may not have been that prevalent during the recent global economic downturn, historically governments have resorted to such cartels in times of economic distress. Whether there are any contemporary lessons for policymaking from such historical experience is clearly of relevance to this session and the background paper and its author would address these matters.

4. In interpreting the historical evidence Mr. Parashar cautioned that there were a number of considerations that should be taken into account. One ought to distinguish between the justification for forming crisis cartels, from the subsequent development of such cartels, the objectives and effects of such cartels, as well as the implications for consumers, society, and the work programme of a competition authority.

5. Drawing upon the experience of developing and industrialised countries (in particular, during the latter's early phases of development), reference could be made to specific cartels and to the lessons that could be drawn from such experiences. Such cartels may arise in sharp sectoral, national, and global economic downturns. Where available, evidence on the impact of such cartels should be taken into account. Plus a range of options for policymakers should be identified and compared, affording decision-makers potential alternatives to cartelisation that can be employed during times of severe economic distress.

6. In addition crisis cartels raise a number of matters concerning the application of competition law and policy. Approaches – legal and otherwise – to these matters differ across jurisdictions. In some

jurisdictions there are provisions for the approval of exemptions from cartel law, subject to meeting certain conditions. Those provisions may be administered by the competition authority or by some other governmental body. The determination of penalties against cartels during severe economic downturns and the application of leniency programmes during such times are matters of interest too. With variation in law and practice across the jurisdictions opportunities arise to contrast experience, examine pros and cons, and potentially to identify better practices.

1. Crisis Cartels: Does one size fit all? Historical lessons

7. This section began with a presentation by **Mr. Simon Evenett** on the form of crisis cartels, the potential justifications for such cartels, and historical evidence on such cartels in prior sectoral, national, and global downturns. The principal policy question is whether during such downturns there is a case for encouraging or permitting the creation of crisis cartels. To help lay the ground for the subsequent discussion Mr. Evenett noted that the phrase crisis cartels could be taken to have two meanings. First, it could mean the creation of a cartel between private firms that is not approved by the state. A second interpretation is that a crisis cartel refers to an agreement between firms that a government body sanctions during a period of economic distress. The first type of crisis cartel may well contravene the competition law of the jurisdiction in question, while the second type of crisis cartel may well require an exemption from that law.

8. In principle the matter of whether a crisis cartel has a particular justification can be approached in a number of ways. First, does the introduction of a crisis cartel improve the functioning of a market? Second, does the creation of a crisis cartel improve consumer welfare (or some measure of the allocation of national resources) more than any other available policy with similar cost? A third alternative is whether a crisis cartel attains some non-welfare objective, such as reducing unemployment by a certain amount, at lowest possible cost to the economy? Clarity about the benchmark used is, therefore, important. So is the need to evaluate the merits of crisis cartels relative to other forms of government intervention, including non-intervention. Ideally, the goal should be to identify the best policy responses in sharp economic downturns, not just those policy options that improve matters.

9. The above considerations are of direct relevance to competition authorities and to other government bodies for several reasons. Competition authorities have to decide how much priority to give to cartel enforcement and whether that priority should change over the business cycle. Other government bodies may have to decide whether to intervene, permit, or even encourage the formation of cartels. Some have argued that these questions are of greater relevance to developing countries with fewer public policy instruments effectively available to them during downturns. For instance, developing countries may not be able to afford the same range of bailouts and financial transfers given by industrialised countries during economic crises. Under these circumstances, are crisis cartels the next best alternative available to developing country policymakers?

10. Another important point of context is that tolerating crisis cartels goes against two decades of tougher enforcement against price-fixing and the like in both developing and industrialised countries. If the policymaking community were to accept that there are circumstances under which crisis cartels could be justified then this would mark a significant point of departure from prevailing views on cartel enforcement. Many of country contributions to this session discussed this very matter.

11. As to the economics of crisis cartels, this is contested. The dominant view among the competition policy community is to be contrasted with that of certain development economists, who argue that the institutions and circumstances of developing countries warrant a different approach to crisis cartels. The first view is that crisis cartels – as other cartels – raise prices above incremental costs and so harm customers, limit output, and distort market outcomes away from efficient outcomes. Also during crises bid

rigging cartels reduce the effectiveness of fiscal stimulus packages by reducing the value for money obtained by state purchasers, the number of units purchased and therefore the increase in labour demand. There is also some evidence that cartels slow down the transfer of technology to firms in developing countries.

12. The attention given to incentives in the first view has implications not just for the justification of crisis cartels. With respect to the enforcement actions against cartels, the desire to avoid forcing the exit of cartel conspirators from a sector implies that in a crisis, when demand tends to be lower, fines may have to be lower than otherwise. In turn, this reduces the deterrence effect of a cartel enforcement regime, perhaps calling for consideration of alternative sanctions for cartel law violations.

13. In contrast, the heterodox view emphasises a different set of factors. On this view the first point to note is that the analysis of cartels originated in the 19th century when, principally German, authors stressed that cartels were useful devices for bringing supply and demand back into balance within industries. Cartels facilitated, it was said, the closure of capacity. Moreover, some argued that one purpose of cartels was to prevent crises resulting in the monopolisation of a sector. The fear at the time was that without cartels the lowest cost firms would take over an industry. Cartels were seen then as a way to constrain those lowest cost firms, although this begs the question as to why the latter would voluntarily agree to or comply with any cartel accord.

14. More recent defences of crisis cartels have argued that, in evaluating their merits, it is important to compare two costs: the cost of market power that are created by a cartel and the cost of forgone economies of scale if output in an industry is allocated across a large number of smaller firms instead of being spread over a small number of large firms as the result of the accord. Certain heterodox development economists argue that the former are smaller than the latter, and so conclude that cartel-encouraged rationalisation is to be encouraged. That, at least, is the contention, whether the evidence supports the heterodox interpretation is another matter.

15. Turning to the evidence on crisis cartels, Mr. Evenett noted that there was relatively little quantitative evidence of the impact of these accords. He highlighted five findings from the empirical record on crisis cartels. First, it is sharp price falls – rather than other features of crises – that appear to trigger the creation of crisis cartels. Second, when a government intervenes to create or allow a crisis cartel, the government's intervention rarely stops there. Over time there is a strong tendency for other regulations to be sought by incumbent firms and policymakers pursue their own objectives through additional interventions. Third, in sectors facing competition from imports, the creation of a crisis cartel is often associated with measures to curb or eliminate those imports. Crisis cartels, therefore, frequently involve an international trade dimension. Fourth, although studies have shown that crisis cartels have raised prices and limited output, not a single estimate of the harm done to customers could be found. An important piece of information for policymaking is, therefore, missing. Finally, none of the alleged benefits of crisis cartels – mentioned above – have ever been estimated. So there is no way of knowing if the losses to customers that follow from the creation of a cartel are offset, partially or fully, by benefits to other parties. Mr. Evenett concluded that the existing literature is far from complete and that it is hard to base an argument in favour of crisis cartels on the basis of the available empirical evidence.

16. Mr. Evenett's presentation concluded with some remarks about the resort to crisis cartels in the recent global economic downturn. He argued that the many contributions from countries and his own research suggested that resort to crisis cartels had been rare in recent years, subject to the caveat that some crisis cartels may remain undetected. Instead of resorting to crisis cartels many governments appear to have engaged in widespread subsidisation of firms in trouble.

17. In at least one important respect, he argued, subsidies are more effective than cartels because the impact of financial infusions is felt immediately whereas the creation of a cartel takes time to affect prices,

sales, and revenues of cartel members. An important implication for policymaking follows. That point is not that subsidisation is the optimal response. Rather it is that supporters of crisis cartels must show that their proposals are less harmful, or more beneficial, than other available policy instruments, such as subsidies. In this regard it is important to point out that developing countries may not have the resources to offer subsidies from their state budgets. However, it should be noted that some developing countries direct their banking systems to advance loans to distressed firms, which can result in an indirect form of subsidisation. In industrial and developing countries, then, there are plausible alternatives to crisis cartels and so the case for the latter should not be made without reference to the former.

18. This last point also implies that competition advocacy by competition authorities should identify and highlight plausible alternatives to crisis cartels. Such advocacy need not be confined to those government bodies responsible for the evaluation of requests for exemptions for cartel law, but also to the press and to other opinion formers that might be influential.

19. After this presentation of the background paper, several official representatives made interventions. A representative from **Korea** elaborated on that country's enforcement experience with respect to recession cartels. Under Korean law such cartels must be approved by the national competition agency. Approval turns in part on whether the sector in question is in recession and here Korean law impose three requirements.¹ Even if a recession can be shown to exist, there are four circumstances under which the Korean competition authority can deny the creation of a recession cartel.²

20. The application of these rules to a request for a recession cartel from the ready mix concrete industry in 2009 was then described. This request was denied precisely because the industry could not demonstrate to the satisfaction of the Korean competition authority that it was in recession. The speaker also suggested that the authority probably would not have been persuaded by the separate argument that this industry's woes could only be addressed by the creation of a recession cartel. Finally and separately, the role for competition advocacy mentioned above was endorsed in this intervention.

21. Thinking on the merits of cartels in **Germany** has evolved considerably since the 19th century, a representative from that country suggested in an intervention. No longer are cartels seen as the outcome of unrestricted trade and are, on that view, unobjectionable. During the hyperinflation of the 1920s the pernicious effects of cartels on customers were recognised and policy evolved in response. For this reason contemporary views cast doubt upon the contention that a crisis cartel can be justified merely because there has been an economic downturn.

22. Turning to other arguments for crisis cartels, the speaker from Germany noted that while there may be legitimate reasons for a developing country government to seek to stabilise prices of certain goods and services there were three practical reasons why a cartel-based solution was unwise. First, such cartels are difficult to set up in a timely fashion. Second, these cartels are very difficult and costly to monitor. Finally, recession cartels are difficult to unwind after they are set up, not least because the sector involves

¹ The three requirements are (i) that demand for the products in question has continued to decrease and remains far below potential supply for a long period of time and that this situation is likely to remain so, (ii) that the price paid by customers is below the average total cost for a certain period of time (ensuring losses are being made), and (iii) that a considerable number of companies in the sector in question are having difficulty growing, therefore ruling out cases where only a few firms are facing difficulties and are seeking a recession cartel.

² The four grounds for denying a recession cartel are (i) that the proposed cartel goes beyond what is necessary to meet its stated purpose, (ii) that the proposed cartel has the potential to "unfairly" harm customers, (iii) that the proposed cartel "unfairly" discriminates in favour of some members over others, and (iv) that there are limitations on joining or withdrawing from the proposed recession cartel.

parties that get to know each other very well during the cartel phase. Good intentions may well founder on the back of these practical concerns. More generally, the speaker argued, developing country competition authorities should not be tasked with the implementation of industrial policy considerations.

23. A participant from **the European Commission** made several observations. It was noted that firms have alternatives to cartelisation, including mergers, joint ventures and other legal forms of co-operation (on research and development, for example). With respect to the latter, it was noted that in December 2010 the European Commission issued a new set of guidelines. More generally, the existence of alternative corporate actions highlights the pitfalls of considering proposals for crisis cartels in a vacuum.

24. This participant also acknowledged the challenges that arise when sanctioning cartels during a sharp economic downturn. The European Commission has developed a complex set of criteria to evaluate the ability of cartel members to pay. However, it was stressed that the application of those criteria was separate and subsequent to any initial decision for infringing cartel law.

25. The final speaker in this section was from **Chinese Taipei**, who described their experiences with respect to the approval of exemptions from cartel law. Exemptions for recession cartels were allowed but applicant firms have to submit a “Concerted Action Assessment” report as well as meeting other criteria, such as demonstrating that market prices had fallen below average production cost. Until now only one application for a recession cartel had been filed, by the man-made fibre industry in 1992. This application was turned down by the competition authority on the grounds that the industry as a whole was expected to survive.

2. Crisis Cartels and the reallocation of resources

26. **The Chairman** introduced the principal theme to be discussed in this section, namely, whether during a sharp economic downturn the “need” to reduce excess capacity in a sector provides a rationale for co-ordinated responses among firms – including potentially the creation of a crisis cartel. In so doing a direct potential link between resource allocation during economic downturns and crisis cartels could be developed.

27. The first speaker in this section **Mr. Ian Christmas**, Director-General of the World Steel Association, addressed this theme by making reference to the steel industry. Having noted that the total amount of steel produced worldwide was 1.4 billion tons in 2010 and that the global steel industry is very unconcentrated (where the largest steel firms accounts for less than eight percent of total worldwide steel production), Mr. Christmas focused on legal cartels in the steel sectors motivated by “crises”. Whenever a steel company is in severe financial troubles it claims it is in a crisis. The question for policymakers, he contends, is whether the firm's problems are a cyclical one (in which case tiding the firm over may be appropriate) or a structural, competitiveness one (in which case, unless firm practices are reformed, state intervention may be useless). Given the considerable fluctuations in demand in the steel business, claims that a firm's difficulties are cyclical cannot be ruled out. Moreover, some governments are concerned about the social consequences of a firm's potential collapse (on unemployment and possibly the environment) and this may influence state responses. Finally, the impact of any collapse on the buyers of steel might be taken into account. Overall, then, in practice a number of factors determine the decision to intervene.

28. Another important factor are changes in the business models of the firms themselves. This is of particular relevance to the steel industry, especially in recent years. In 2009 steel use in OECD countries fell 30 percent compared to the previous year, meanwhile steel use grew in China, India, and in Latin America. Despite this variation there have not been many departures from the steel industry and this is because companies – the speaker cited Nucor, the largest U.S. producer, favourably in this regard – had altered their business models so as to be able to better survive over the economic cycle. Other steel firms,

in particular in Europe, were assisted by economy-wide government schemes to subsidise employment. This recent intervention stands apart from the cartel-related tools used yesteryear in the steel industry, that include price controls, production quotas, import and export restrictions, restrictions on raw material prices and trade, as well as direct subsidies for particular companies and employees.

29. The speaker gave the 1970's Davignon plan as an example of a crisis cartel in the steel industry. After the first international oil crisis in the 1970s European governments were heavily subsidising their steel firms, so much so that the European Commissioner responsible, Vicomte Davignon, felt these subsidies were becoming a threat to the formation of a future common market. As a result, a system of price controls, production quotas, trade restrictions, and bans on the use of subsidies were imposed on every steel producers in the European Economic Community. The speaker noted that social pressures were indeed eased, perhaps at the expense of the performance of the more competitive steel plants. Overall, it was argued, the so-called Davignon plan went on for too long and stalled the rationalisation process in the European steel industry.

30. The speaker gave two other examples, one from India and from the United States. Up until the early 1990s there were only two steel producers in India, only one of which (Tata) was in the private sector. New investment in the flat steel sector was banned and production quotas in force. Once lifted, along with reductions in import tariffs on steel, the steel sector in India blossomed. Entry resulted in a sector in which there are now five or six major producers and productivity has increased considerably. The speaker conceded that this adjustment was made easier in an economy whose growth rate has accelerated over time and where the demand for steel has grown correspondingly.

31. The restructuring of the steel industry in the United States in the early part of the last decade had benefited from cartel-like interventions, the speaker asserted. In particular, the imposition of trade restrictions relieved U.S. steel firms of competitive pressure from abroad. Consolidation followed, including foreign firms buying up U.S. steel plants. The U.S. government took over the substantial pension liabilities of steel companies and trade unions came to new arrangements with management. As a result of these changes the American steel industry is much more competitive internationally than it used to be.

32. The speaker then turned to the lessons for developing countries. He argued that rising steel demand in emerging markets did not always provide sufficient economic justification for developing steel production there. Economies of scale are not needed for a steel plant to thrive and grow; small scale producers can be competitive. For this reason the arguments often advanced for infant industries do not apply to the steel industry. Worse, to the extent that protectionism is used to protect a national steel sector it raises the prices paid by steel buyers that are almost always other national producers.

33. To conclude, Mr. Christmas recommended that any legal cartels be temporary and be specified with clear business objectives. Policymakers should be mindful of the special pleading of corporate interests. He acknowledged that this may be far from easy. Even so, public interest considerations should guide policymaking.

34. This introductory presentation on the steel sector was followed by four interventions from country participants. A representative from **Brazil** spoke first and expressed some scepticism concerning the logical and empirical case for crisis cartels. A cartel implemented as a result of a sharp economic downturn would effectively transfer the harm done by the downturn from producers to customers and this was unacceptable. Consequently, alternatives to the creation of a cartel should be considered.

35. Brazilian experience with crisis-motivated cartels reinforced this representative's scepticism. Instead of stimulating the sectors that were cartelised, an anti-competition culture developed that has persisted to this day. These lessons have been taken on board and two recent applications from the sugar

and alcohol sectors for permission to form associations, that would have distributed quotas and sold production jointly, were denied.

36. An **Irish representative** described the Irish beef processing industry case, which was the subject of both official and judicial scrutiny in the 1990s. The case began in the 1990s when, for various reasons, demand for Irish beef fell. A government report recommended rationalisation of the sector and this was taken up by the industry which proposed the creation of the Beef Industry Development Society (BIDS). The proposed scheme would facilitate exit from the beef sector with the remaining firms paying a levy that was to be used to compensate the exiting firms.

37. The Irish competition authority refused to grant an exemption for the BIDS scheme from national competition law because it felt that the claimed efficiencies were not demonstrated adequately and that market forces could have effectively facilitated the rationalisation of the beef sector. This decision was contested in the courts. Ultimately, the Irish Supreme Court supported the authority's judgement and the beef industry decided not to implement the agreement. Specific reference was made to the utility of the European Commission's guidelines on agreements that might facilitate the rationalisation of sectors.

38. These comments from the Irish representative were reinforced by an intervention from the European Commission. The latter highlighted the importance attached to the guidelines for implementing Article 101 (3) of the Treaty on the Functioning of the European Union. In this speaker's view an agreement by firms to reduce overcapacity constitutes a restriction of competition by object. The only way to make such an agreement legal is to fulfil all the conditions of Article 101 (3) and, in the speaker's view, this is very difficult. Not only must efficiencies be demonstrated and there must be no less competition-restrictive means of achieving those efficiencies than the proposed agreement. Specific attention should, it was argued, be given to the incentives faced by individual firms to reduce capacity. If those incentives are strong, why do firms need to co-ordinate in order to facilitate rationalisation of a sector?

39. The gilthead sea bream case, considered by the Hellenic Competition Commission, was the subject of an intervention from a representative of **Greece**. The gilthead sea bream sector is a major exporter and sought an exemption from national competition law to facilitate rationalisation of production capacity. The sector claimed that there was over-production, that prices were below production costs, and that exit was expected, which in turn would hurt consumers. This notification was rejected by the competition authority on several grounds. First, the firms concerned did not produce a convincing restructuring plan. The competition authority suspected that the firms in question were not that interested in consolidation and specialisation, but rather in the proposed agreement to raise prices. Second, the overcapacity that existed was due to bad judgement on the part of the firms involved and not due to some other factor, such as a demand slump.

40. The final observation in this section came from a representative from **the United Kingdom** who argued that a government-sanctioned cartel, however short-lived, is likely to result in co-ordinated behaviour among firms after the official cartel lapses. Whatever short term benefits, if any, arise from the creation from crisis cartels will, by this logic, be offset in part or wholly by adverse longer term effects.

3. Crisis Cartels and price instability in developing countries

41. In recent years commodity price instability and the prices witnessed in the agro-food sector have been the subject of much concern among policymakers, **the Chairman noted**. Transitory shocks in these development-sensitive sectors can jeopardise the survival of marginal market participants threatening, for example, farmers' livelihoods when prices are very low and the welfare of poor buyers when prices are very high. Some have contended that cartels in sectors affected by transitory shocks could stabilise prices

and the purpose of this section was to explore these matters in greater depth. Two expert presentations facilitated this discussion.

42. The first presentation was made by **Mr. Steve McCorriston**, Head of the Department of Economics at the University of Exeter. He began his presentation with an observation that ten years ago international organisations were interested in whether market manipulation or international commodity agreements could reverse the low prices seen in agricultural and food markets. Nowadays these prices are much higher (although the price surge seen in 2007-8 was in fact less severe than in 1972-4), but the question before policymakers is still the same. The speaker also questioned the strength of the linkages between developments in commodity markets, crisis cartels and competition factors more generally. Apparently competition perspectives have not received as much attention as they could have in discussions on food security, despite the attention given to the latter in the past few years. In that regard the speaker made reference to recent media reports to food price inflation in Bolivia, China, and India.

43. In order to better understand the role that competition factors might play in accounting for food and commodity price behaviour a number of distinctions should be borne in mind. First, high prices (more generally, the level of prices) and the volatility of prices are conceptually distinct. Competition-related factors may affect each differently. Second, it is important to distinguish between prices of food and commodities in national markets and the comparable prices in international markets. The extent to which shocks in global markets influence national prices is an interesting matter and may speak to the level of competition in the distribution sector. Third, price volatility of final goods (such as unprocessed and processed food) may be affected by shocks to the costs of key inputs.

44. The degree of price transmission between global and national markets and between input and final goods markets has been the subject of research. Less competitive markets typically see less than one-for-one pass through. Indeed, the speaker contended that as a first approximation (and assuming markets to be competitive), the extent of pass-through should be related to the share of the raw commodity in downstream firms' costs. This share can be relatively small particularly for processed food products. If markets become less competitive – potentially in response to the creation of a crisis cartel – then the rate of pass through would in principle fall, lowering the degree of perceived price volatility. In which case, price hikes in global markets or in input markets would be absorbed in profit margins more than before.

45. Overall, then, if a market for food or commodities becomes less competitive there would be effects on the volatility as well as the level of prices, each of which affects customers and producers. The speaker reminded participants that in some markets in developing countries the producers just as well as their customers could be facing poverty. The competition policy community often privileges customer welfare over producer welfare; a developmental perspective might legitimately consider the impact of changes (firm-led or policy-led) in agricultural and commodity markets on poor producers too. For these reasons the speaker argued that agricultural markets may be more development-sensitive than most and the application of competition principles should be more flexible.

46. Trade in agricultural and commodities, and in the inputs necessary to make them, can be affected by cross-border anti-competitive practices. The speaker made reference to a recent proposed – but failed – international takeover that would have had implications for the prices charged in world fertiliser markets. Likewise, an export cartel for rice involving certain Asian governments, advocated during the recent global economic downturn and associated with the recent price spikes on world commodity markets, highlights how competition-related factors can shape market outcomes in these development-sensitive markets. These competition-related factors are not to be confused with other developments, such as export bans, which fall under the remit of trade policy.

47. The second presentation in this section, given by Mr. Jenny, focused on a specific government induced cartel: the International Coffee Agreement which lasted from 1962 to 1989. This cartel enhanced the terms received by the very large number of poor coffee farmers in developing countries to the detriment of the then four principal multinational buyers of coffee. Without this cartel, it was contended, the latter would have used their considerable market power to negotiate prices that would have lowered the incomes of the former.

48. The market for coffee is concentrated both on the buyer and seller sides, with a small number of countries responsible for a large proportion of consumption and production. The total volume of coffee sold is greatest in the United States, whereas to largest volume supplier is Brazil. Moreover, for a small number of countries (Burundi, Ethiopia, Rwanda, and Uganda being examples) overseas revenues from coffee sales constitute a large share of total national exports. For these countries the level and volatility of coffee prices, the latter being quite substantial due to the length of the growing cycle and the price inelastic nature of demand, have important implications for macroeconomic stability as well as for the welfare of coffee farmers.

49. In the 1950s and 1960s the International Coffee Organization attempted to establish a worldwide cartel for coffee to counter low prices and high price volatility. Thirty-seven countries signed an International Coffee Agreement (ICA) in which a quota system for the exports of coffee was established. Interestingly the largest coffee consumer, the United States, was a member of this agreement and was central to the monitoring of this accord. The cartel system operated from 1962 to 1989, when the United States withdrew from the ICA. While the impact of the cartel was to raise prices, the effect on coffee price stability was less clear. Price spikes still occurred, such as that observed in 1975 following a major frost in Brazil.

50. Why did a major consuming nation support the cartelisation of a product that it buys? The speaker argued that the ICA was seen as enhancing the economic stability of a number of developing nations and this met certain foreign policy objectives of the United States during the Cold War. Moreover, by being a party to this agreement, the United States could “protect” by influencing the degree of harm done to US consumers through the level of imported coffee prices.

51. Following the collapse of the ICA, the introduction of a new technology which enabled the processing of Robusta coffee beans as well as the considerable expansion of coffee production in Vietnam led to an imbalance between supply and demand and a substantial decline in prices over time. Farmers are reported to have substituted production away from coffee towards other crops, which in turn has created problems. In East Africa an alternative response has been to develop niche products and to market higher-end coffees.

52. From this episode the speaker drew the following lessons. First, the lack of diversification in many developing countries implies that price volatility has developmental implications, not least through affecting the incomes of vulnerable farmers. Second, in the case of coffee the international cartel that existed between 1962 and 1989 did maintain prices and reduce price instability and therefore met its signatories' objectives. Third, while certain financial instruments could have insured producers against price volatility, they were not developed at the time this cartel was in operation. Other alternatives, such as mergers, would not have been feasible on a large enough scale without generating huge concentrations of land ownership in developing countries. Fourth, while a niche strategy was an alternative for some producers, whether it is a generalised solution remains to be established. Having said all this, the speaker wondered if the adaption to market and technological developments might have been faster in the absence of the cartel.

53. These two presentations were followed by four interventions from representatives of developing countries. The first intervention came from **Colombia**, where an official recounted the cartel exemptions that may be granted under that nation's competition legislation. It turns out that the national competition authority has never accepted an application for an exemption. To the contrary, the authority has enforced its cartel law rigorously during sectoral, national, and global economic downturns. Specific reference was made to investigations into the pricing of sugar cane (where a cartel existed from 1993 to 2010) and into the green onion and pasteurised milk industry. In both of the latter cases, which involve food and so affect the cost of living, falling prices were used by market incumbents to justify cartelisation. Arguments that each sector was in crisis were rejected by the competition authority.

54. The second country intervention was from **Costa Rica**. This representative noted that the enforcement of cartel law in times of crisis often led the competition authority to be painted as heartless, attacking arrangements that jeopardise the incomes of poor farmers and producers that have few perceived alternative sources of income. In Costa Rica there is no mechanism for the competition authority to grant an exemption to cartel law in a crisis, or indeed in any other circumstances. When the most recent competition law was being debated proposals were made to include such a mechanism but ultimately they were rejected. The rejection was appropriate as crisis-related exemption mechanisms beg more questions than they answer. For example, what constitutes a crisis? Does a crisis need to be global or can it be sector-specific? Are crises always associated with excess capacity? Which body determines whether a crisis is over and that the cartel needs to be disbanded? Which body determines the rules by which the cartel will operate? Who is the cartel trying to protect? Instead of answers to these tough questions, it was argued, we know for sure the answer to the following question: Who is going to pay for the cartel? Customers.

55. The speaker from Costa Rica emphasised that they were not against government intervention *per se*. Indeed, government intervention that makes industries more competitive is to be welcomed. However, the reality is often different as interest groups seek favour from governments. Worse, as noted in the background paper, demands for government support rarely cease with exemptions from cartel law. These demands were said to be particularly damaging in industries that produce or cultivate materials bought by other sectors. Recognition of such damage is growing in Costa Rica, it was argued, as the Agriculture ministry recently referred certain proposed regulations to the competition authority for examination, opening the door to competition advocacy by the authority.

56. The third country intervention came from **Indonesia**. Times of economic crisis were ones where, the speaker said, firms might co-ordinate their actions to cut production or otherwise act as a cartel. While this may harm buyers the alternative is bankruptcy and exit from the market. Moreover, there are some basic needs of the public (in food, agriculture more generally, health care, and energy) where prices become more volatile and can rise sharply. Under these circumstances producers may co-ordinate actions so as to stabilise prices. In the light of these competing considerations many have argued that, in times of crisis, competition law enforcement should be relaxed.

57. In Indonesian competition law (Law number 5 passed in 1999) there are grounds for providing exemptions for cartels. Article 3 allows for exemptions to safeguard the public interest and to improve national economic efficiency. Article 50 allows for exemptions on the grounds of meeting the objectives of national legislation (including regulation) or for promoting exports, so long as the additional exports do not interfere with supplies to the domestic market. Such exemptions are only granted after a thorough analysis by the national competition authority. Moreover, the authority can submit suggestions to other government bodies to revoke or improve regulations and their implementation.

58. The outcome of two recent Indonesian cartel cases with potential development significance were then summarised. In an investigation of the price of cooking oil, the Indonesian competition authority found that suppliers did not cut their domestic prices as quickly as they raised them in response to

fluctuations in comparable world prices. Such asymmetric price transmission was part of the evidence used to find the relevant suppliers guilty of price fixing. A case involving airline transportation services was resolved on a similar basis.

59. This enforcement experience prompted the speaker to conclude by raising several questions. During economic crises under what circumstances can a cartel fall beyond the application of competition law? In what ways during times of economic crisis can a competition authority take proper account of the interests of the lives of many people in the country, bearing in mind many are poor and face loss of jobs? Can the design and application of competition law be used to dampen price fluctuations of public goods and services?

60. The final intervention came from **South Africa** whose competition law has a well-known public interest exemption. The speaker acknowledged upfront that this exemption causes concern among local businesses that fear it will be applied arbitrarily and by what were referred to as competition purists that regard this exemption as altering the way in which enforcement decisions are taken. It was contended that, in practice, this exemption was not used widely. The South African competition bodies interpret the law in quite an orthodox manner and are well aware that there are often more effective policy instruments for attaining many governmental goals than competition law.

61. The recent economic crisis has not influenced the enforcement of South African competition law. While that law does allow for exemptions of otherwise prohibited anti-competitive practices on four grounds (promoting exports, promoting small businesses controlled by historically disadvantaged individuals, changes in productive capacity to stop the decline of an industry, and promoting the stability of an industry designated by the relevant Minister), in fact very few exemptions have been granted. Those exemptions that have been granted relate principally to promoting exports and certain small businesses.

62. As for an exemption based on the decline of an industry it was argued that this is a double-edged sword for the firms in question. After all, the invocation of such an exemption sends a clear signal to the financial markets of the incumbents' own assessment of their industry's prospects, calling the former to question the competence of the incumbent management. The speaker readily acknowledged that, from the perspective of promoting competition, granting of such an exemption might lead to firms continuing to co-operate after the exemption lapses.

63. With respect to an exemption designated by the Minister, the legislation contemplates a situation where an industry cannot survive without cartelisation. This exemption was enacted as a result of lobbying by the diamond sector, where price instability is a concern for suppliers. Ultimately, only one exemption has been granted under this provision and that was to the petroleum industry around the time when the football World Cup was held in South Africa. There are, however, two pending applications before the Minister for such exemptions, in the dairy and health care markets.

64. The speaker described how an application for an exemption from the maize industry, citing the promotion of exports and the economic instability, was turned down by the South African competition authority. Without such an exemption, the industry argued, farmers would not invest for the next growing season and this would cause future problems of food insecurity. The authority found the evidence to support this claim unconvincing. Moreover, the Minister did not issue a certificate stating the industry was having difficulties.

65. Even when there is Ministerial involvement in the exemption process the speaker emphasised that it is the competition authority that ultimately makes the decision on whether to issue the exemption. It does so after publishing notices in the government gazette, inviting comments from stakeholders, and on the basis of evidence. In granting exemptions the authority specifies exactly what behaviours are exempted and for how long.

4. Is there a trade-off between development and efficiency that could justify crisis cartels?

66. The fourth section was introduced by **the Chairman**, who noted that in principle there could be a trade-off between development - or other economic considerations such as financial stability -and efficiency during crises. The question before participants is whether that trade-off provides adequate justification for the creation of cartels in certain sectors during economic crises? The Chairman then introduced the first speaker, **Mr. Andrew Sheng**, chief advisor to the China Banking Regulatory Commission, whose focus was on crisis-related developments in the financial sector.

67. Mr. Sheng began his presentation by noting that in his 35 years as a financial regulator this was the first time he had met competition regulators, implying that there was insufficient communication between financial regulators and competition regulators. This was a comment that others later would remark upon. The first substantive distinction he made was between cartels in the real sector, where the losses from the exercise of market power were in his view tiny compared to the costs of market failure in the financial sector. The latter is a natural oligopoly with strong network effects between participants whose commercial viability tends to rise and fall together. Regulatory, tax, and information arbitrage are also part of the competition between firms in the financial sector – and when regulations become too demanding then activity migrates to an unregulated shadow banking system.

68. Under these circumstances it is not surprising that financial regulators have examined whether there is a trade-off between efficiency (driven by competition) and stability. Some contend, Mr. Sheng noted, that a more concentrated financial system is a more a stable one. Concentration in small emerging markets may lead to oligopoly in the internal market, but these large local players are in fact relatively small when compared to the size of the global market, which is the relevant comparator for those economies whose financial systems are integrated into global markets. What is worrying, in his view, is the concentration at the global level in certain financial segments. The latter concentration can lead to so-called momentum plays and market manipulation, since many of the off-shore and over-the-counter markets are non-transparent and largely unregulated. Moreover, since every concentrated financial player is a counterparty to most, if not all, other major players then concentration is in reality associated with greater potential global financial instability, not less.

69. The speaker also pointed to other, non-competition-related factors that have exacerbated financial instability: poor internal risk management by financial institutions, poor regulatory oversight, failure to separate investment banking from retail banking, and government guarantees for depositors and others that generate moral hazard. Mr. Sheng argued that Australia, China, and Canada were not so adversely affected by the recent global financial crisis, precisely because they focused their banks' activities on retail operations and not on building the leverage associated typically with investment bank functions. The history of prior speculation taught policymakers in Australia and Canada to have concentrated banking systems – even cartelised systems he claimed – that are reviewed from time to time by competition regulators or other parties that are concerned with promoting efficiency. More generally, Mr. Sheng advocated attention to national circumstances and doubted whether any sound best practice to guide policymaking could be identified.

70. Following this presentation were interventions from two OECD members. First an official from **Australia** explained that in his country the promotion of competition and stability were seen as complementary goals of government policy. It is accepted that competition between banks can have implications for both and that bank sector outcomes can have important knock-on effects for the rest of the economy, and these must all be taken into account. In Australia the competition authority confines itself, however, to the assessment of mergers on the intensity of competition, whereas the Australian Prudential Regulatory Authority concerns itself with any consequences for financial stability. The resilience of the Australian financial system during the recent global financial crisis should, it was argued, be attributed in

part to this system of regulatory oversight, demonstrating that it is possible to design regulatory systems to simultaneously meet policy objectives relating to competition and financial stability.

71. A representative from **Portugal** noted that national financial systems have three functions, relating to mobilising savings and investment, operating payment systems, and undertaking risk management. Four types of transactions were associated with these functions: spot transactions, risk-adjusted non-spot transactions, payment transactions, and securitisation (the shifting of risk to others). Having characterised national financial systems thus, this representative asked what role there was for competition authorities? Examining fees for spot transactions, the ease with which customers can move between financial suppliers, and the impact of state aids and financial guarantees are clearly areas where competition authorities can contribute. However, it was argued, when it comes to risk-adjusted transactions and premiums paid for insurance and securitisation, much more care is needed as clear answers are not so readily available.

72. This representative agreed with the presenter that the implications of state guarantees and financial institutions being “too big to fail” needs to be solved. However, the presenter's apparent assumption that all concentration led to cartelisation was contested by this representative. A more nuanced appreciation of the differences across markets and firms was recommended here. Moreover, while the representative agreed that there may be no single policy prescription for all countries concerning the regulation of financial services, the presenter's recommendation that investment banking and retail banking be separated was rejected on the grounds that this is a matter for regulators to decide, not competition authorities.

5. Wrap up and general discussion

73. The Chairman of the session asked Mr. Evenett and Mr. Jenny to summarise the key lessons from this session's deliberations. Mr. Evenett highlighted three lessons. First, although few, if any, participants defended the heterodox views in favour of crisis cartels, as a practical matter governments should have the means and established procedures to evaluate proposals for such cartels during economic crises. A number of jurisdictions in fact have sophisticated procedures which have been applied in practice and other jurisdictions may want to reflect on this experience.

74. Second, there are alternative public policy measures available to governments in both developing and industrialised countries that might improve market outcomes more effectively than crisis cartels. This points to an important role for competition advocacy by competition authorities, as they seek to influence governmental decision-making during economic crises.

75. Third, in markets where prices are volatile or where the consequences of volatility are severe (possibly for producers as well as consumers) crisis cartels are an option but, again, not necessarily the only practical option. Financial market and other innovations should be considered as well.

76. Mr. Jenny began by noting that there was agreement that there are better alternatives to crisis cartels as both means to solve economic crises or to mitigate crises. What remains open is to decide how far the competition community goes in developing its thinking about alternative approaches. This is all the more necessary as there have been important policy debates - over food security and financial stability - where the competition perspective has barely been aired over the years.