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BEFORE THE COMMISSION OF INQUIRY ON PUBLIC
CONTRACTS IN THE CONSTRUCTION INDUSTRY
OF THE PROVINCE OF QUÉBEC

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Background

- I am a researcher and teacher with a fascination for the hidden world of cartels.
- I am an occasional consultant for plaintiffs in antitrust damages cases.
- I am a citizen worried about the decline of public morality. Effective cartels transfer enormous amounts of wealth from trusting customers to the cartelists.
- They are the enemies of fair competition and have no redeeming features. Economists and the laws of practically every world jurisdiction universally condemn private cartels.

A SHORT HISTORY OF CARTELS

- Cartels are voluntary organizations of companies in the same industry that explicitly agree to increase their collective profits by controlling market prices or reducing market quantities.
- The construction industry is a hotbed of anti-competitive behavior everywhere.
- Construction cartels typically have many members (31) and long lives (11 years).

INJURIES TO BUYERS FROM CARTELS

- Buyers are harmed by *overcharges*, by the *dead-weight loss* (lost output), and *time*.
- Construction cartels typically overcharge 15% to 20% of cartel sales.
- Dead-weight losses add 12% to 31% more.
- Time reduces compensation to victims by 50% to 100%, unless post-judgment interest is awarded.

WHAT WENT WRONG IN QUÉBEC?

- The intersection of business malpractice, organized crime, physical intimidation, and payoffs to political powers is deplorable.
- But from an historical point of view, the Québec cartel story is mostly banal.
- The use of kickbacks to Québec's political parties does make the present case very unusual in the annals of cartel history.

PUBLIC ANTI-CARTEL ENFORCEMENT

- An international consensus has developed that the objective of anti-cartel laws and enforcement is best supplied by the principles of *optimal deterrence*: nip the crime in the bud (*ex ante*).
- A second economic theory of crime has become known as the *dissuasion* approach. It assumes that the collusive, gang-type crime has already started (no deterrence is possible) and focuses on instilling distrust among gang members (*ex post*).
- Both schools have logically proven that their remedies will work.

Effective Public Policy Types

1. Increase the perception by would-be cartelists that secret cartels are highly likely to be caught and punished (i.e., the “*probability of detection*”).
2. Monetary penalties for corporations or individual executives that are designed to deter cartel formation.
3. Imprisonment of the individual perpetrators.
4. Dissuasive monetary penalties.

WISE PUBLIC POLICY?

- It is important to establish public policies that deter the *formation* of price-fixing (or bid-rigging) cartels, but if that is not possible, then policies that encourage the break-up of existing cartels are an appropriate back-up.
- Some policies are consistent with both theories.

Raising the Probability of Detection

- The first line of defense against bid rigging is to structure the **rules of the auction** that determines the winner of the public tender.
- Such as: do not reveal all bids, make the 2nd-lowest the winner, do not award solely on price, give extra points to 1st-time bidders.

Leniency Policies

- The most widespread tool is the implementation of leniency or amnesty policies for corporate cartelists
- Some jurisdictions permit individual employees with evidence of price fixing by their employers to receive leniency.
- Bounties for individual whistle-blowers

Monetary Penalties to Deter

- Corporate monetary penalties that optimally deter are inexpensive to administer but quite high -- perhaps politically intolerable.
- Individual fines tend to be very low, but could be an effective supplement if based on personal assets.
- Civil damages usually supplement government fines, but in the U.S. greatly exceed them.

Imprisonment

- U.S. courts handle almost all the world's prison penalties for cartel offenses. The majority are non-U.S. residents.
- While legal in Canada, incarceration is absent.
- A year in jail is worth less than \$6 million, so imprisonment is weaker deterrence than corporate fines.
- Yet, prison as a mix of penalties can be optimal in deterring cartels.

Cartel Dissuasion

- Rather than setting fines to make collusion *ex ante* unprofitable, dissuasive fines need only make existing cartels *unstable* by targeting the least profitable participants.
- Dissuasive fines are less than optimally deterrent fines, thus politically more popular.
- A radical idea: the dissuasion school can prove that cartels are guaranteed to be eliminated if the fines to be imposed on all the cartelists are distributed *to the amnesty applicant*. There is no compensation for citizens.