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Competition policy in the global era

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ABSTRACT
I discuss some of the implications of globalization to the design and application of competition policy. My analysis is divided into three different areas: price fixing, mergers and abuse of dominant position. I also consider the importance of China as an emergent player in the global competition policy arena.

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Introduction

It is a bit of a cliché to say that the world is flatter than it used to be; but it is true. And competition policy is no exception: In the past decades, many countries where competition policy was all but inexistent have become central players. More important, an increasing number of competition policy issues involve firms and regulators from multiple countries.

How is the globalization of competition policy taking place? What challenges does globalization place for competition policy? These are some of the questions I propose to address in this paper. The first part of the paper is structured according to a common classification of competition policy areas: price fixing, mergers and abuse of dominant position. Next I consider the specific case of China as a new player in the global competition field. I finish with some concluding remarks.

Price fixing

Horizontal practices — in particular price fixing — represent the earliest dimension of competition policy. (While I am aware of the subtle distinction between antitrust and competition policy, I will refer to both interchangeably in the present text.) In this section, I briefly describe what I think are the similarities and differences in price-fixing policy across countries; and then focus on the effects of globalization in the particular context of price fixing.

Comparative law and policy

The Sherman Act, passed by the US Congress in 1890, states that

- Section 1. Every contract, combination in the form of trust or otherwise, in restraint of trade or commerce … is declared to be illegal.
- Section 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce … shall be deemed guilty of a felony …

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Since this important landmark in competition policy, many countries have followed the US lead and enacted similar laws in their jurisdictions. For example, Articles 101 and 102 of the EU Treaty largely parallel the main points of the Sherman Act. In fact, the language and the interpretation of the basic principles regarding horizontal practices such as price fixing are remarkably uniform across the world. (The first piece of competition policy legislation was Canada's 1889 Competition Statute; see ABA, 2001; however, it did not become effective until years later.)

The main differences across countries, I would argue, lie on the nature of penalties: criminal in the USA, UK and a handful of other countries; and civil in the rest (including the EU). This is more than a detail. Consider, for example, a series of prosecutions by the EU against cartelization in the synthetic rubber industry. In January 2008, the EU imposed fines totaling Euro 34 million on the Bayer and Zeon groups for fixing prices for Nitrile Butadiene Rubber (NBR). Then Competition Commissioner Neelie Kroes stated (see https://protect-us.mimecast.com/s/arG6BRuz5zwxI2):

> This is the fourth cartel decision in the synthetic rubber industry in just over 3 years. I hope that this is the last. Buyers of synthetic rubber should be concerned about how much these cartels have cost them. And shareholders should be concerned about how much the fines have cost them.

I think there is a lot of wishful thinking in Kroes' hope that 'this is the last'. So long as price fixing is only subject to civil penalties, its practice will continue to be based on a simple monetary cost–benefit analysis. I like to compare it to parking illegally in Manhattan. For many residents, doing so is still a bargain, considering the likelihood of getting a ticket, the value of the ticket and the cost of the alternative (huge fees in parking garages). Likewise, for the manager of a EU-based corporation, there is little to fear from being caught in the act: it is as if EU-imposed penalties were part of the 'cost of business'.

Not so in the USA and other countries where price fixing is subject to criminal prosecution. Even a short stay in prison is bound to have a huge personal cost to those convicted of price fixing. Even if the sentence does not involve actual prison time, being convicted of a crime is bound to be a stronger deterrent than having your employer pay a fine. For example, the US judge in *Christie's and Sotheby's* sentenced Diana Brooks to three years of probation, including six months of house arrest. She was also fined $350,000 and ordered to perform 1000 hours of community service. She did not actually spend time in prison, but the mere fact of being a convicted felon must surely be an important future deterrent.

Global aspects

What has globalization meant for price fixing cases? In this section, I cover five points: jurisdiction; extradition; agency collaboration; independence; and finally the issue of over- vs. under-enforcement.

Jurisdiction

Globalization has shown that jurisdiction is determined by effects rather than firm headquarter location. That doctrine had already been established in cases like *Woodpulp* (European Economic Community 1988), but a close look at recent activity by the US Department of Justice (DoJ) makes it even more clear that enforcement is as global as competition is. On its website, the DoJ lists the fines greater than $100 million that it has applied in price-fixing cases. Two things that jump at you from this ranking: First the largest fines are relatively recent. This results in part from inflation, but only in part: fines in constant dollar value are increasing too. Second, and most important, the vast majority of fines are imposed on foreign firms. If you do business in the USA, you are subject to US law.

Extradition

I mentioned earlier the cross-country differences in the nature of prosecution (civil vs. criminal). But here too the world is becoming more global. One of the most important events in global competition policy that no one seems to talk about is the 2015 extradition of an Italian executive from Germany to the USA, a first-ever event in a price-fixing case. The US DoJ found Romano Pisciotti, an Italian national and former executive of Parker ITR, guilty of bid rigging in the sale of marine hoses in the USA and elsewhere. When traveling from Nigeria to Italy in June 2013, Mr Pisciotti made a stopover in Germany. There he was arrested and, in April 2014, extradited to the USA, where he was sentenced by a Federal District Court to serve 24 months in prison and to pay a $50,000 fine.

In the past, many foreign executives were formally accused of antitrust violations. Going back to the *Christie's and Sotheby's* example, in 2000 Sir Anthony Tennant of Christie's was found guilty of fixing art auction fees with rival Sotheby's. Tennant refused to testify in the USA and could not be extradited from the UK (he died in 2011). Before that, as the result of the DoJ's investigation into alleged cartelization practices by DeBeers, an arrest warrant was issued on several executives of the South Africa and London-based company; but no arrest was ever made and the case was eventually settled.

By declining to appear in the USA to face cartel charges, foreign defendants were free from any punishment. The Pisciotti case marks the first successful extradition ever that is based on an antitrust charge (in this case bid rigging, which is a crime both in the USA and in Germany). As the facts of the case become better known, I expect the global deterrence effect of US antitrust to increase; and, for the reasons mentioned earlier, this may be a good thing.

Agency collaboration

Another relevant note on the globalization of anti-cartel policy is the collaboration between competition policy agencies. Take for example the *Virgin Atlantic and British Airways* fuel surcharges case. Fuel surcharges, the extra tariff placed on tickets to compensate for high oil prices, were introduced by British Airways (BA) and Virgin Atlantic (VA) in 2004. BA wanted to sound VA on the price increase; and over a period of 18 months, six phone calls were made between the two rivals, clearly in violation of the law. Taking advantage of the leniency program, VA provided UK's Office of Fair Trade (OFT) with critical information regarding the phone exchanges; and this was followed by an investigation initiated by the OFT. Since BA and VA fly from the UK to the USA, the US DoJ too initiated a parallel investigation into the BA-VA agreement. Although the two processes were independent and led to different sentences, the agencies collaborated and exchanged information about the case.

Independence

Information from one country's agency may be used by another country's agency; this does not imply that the discovery process in one jurisdiction necessarily applies to another one. Take for example the class action suit brought in Canada in 2008 against the leading chocolate manufacturers. It was proven that the chocolate majors had conspired to increase prices, specifically as the result of discussions at trade shows and association events. The total settlement of the case amounted to more than C$23 million. Mars and Nestlé also faced criminal charges, whereas Hershey was left off the hook thanks to Canada's leniency program. Soon after, a similar class-action suit was also initiated in the USA against the same set of companies. Given the parallelism in prices, as well as the similarities between the two markets, one would have thought the US extension of the Canada case to be a simple matter. However, the US case was dismissed for lack of sufficient proof. The presiding judge stated that

> Nothing scandalous or improper has been discovered within our borders, and no evidence permits a reasonable inference of a price-fixing agreement.

In other words, for there to be an indictment in the USA, one would need to argue that the same companies that colluded to increase prices in Canada also colluded to increase prices in the USA. The suspicion may be deep, but suspicion is not proof.

Externalities

It is one basic microeconomics principle that the equilibrium level of a given private activity tends to be too large from a social viewpoint in the presence of a negative externality; and, conversely, too small when there is a positive externality. Specifically, globalization raises the issue of enforcement when the cartel equilibria in each country are interrelated (Choi, 2013; Choi & Gerlach, 2012a, 2012b). Basically, if breaking a cartel in one country helps prosecuting the same firms as they collude in a second country, then we have a positive externality; and the country-level degree of enforcement is too low from a world point of view. In addition to this possible externality, it is likely that the information possessed by one competition authority is different from that of other ones. All in all, there are reasons to believe the level and quality of enforcement would be better if competition authorities cooperated with each other. (However, as Choi and Gerlach (2012b) show, in the context of leniency programs towards international cartels, information exchange may also lead to undesirable outcomes.)

Mergers

I now move to the second major area of competition policy: mergers. As in the previous section, I first compare the approach taken by the regulatory agencies in different countries, and then address the issue of what globalization has meant for merger policy.

Comparative law and policy

Unlike price fixing, merger policy exhibits some variation across countries. The USA, the EU and other jurisdictions recognize the potential costs and benefits from a merger. However, different countries assign different weights to the different effects of a merger. For example, high enough cost efficiencies can be used as an argument in favor of a merger in Canada, but not in the USA. However, as I will argue next, it is not just a difference in philosophy but also a difference in who is to gain and who is to lose.

One of the most talked about and written about merger cases of the twenty-first century is undoubtedly *GE and Honeywell*, the failed merger between two American firms. I will not go through all of the details of this case, rather review the main facts. There were clear complementarities between the products offered by the two merging partners, to the extent that it was expected that they would bundle (cross sell) many of their offerings. The US regulator (DoJ) saw little to worry about the merger and approved it conditionally on relatively minor divestiture remedies. By contrast, the EU decided to block the merger based on the view that bundling would likely have the effect of foreclosing GE's and Honeywell's competitors. On appeal, GE and Honeywell won a partial victory, but it was too little and too late.

At one level, the difference between the US and the EU decisions might be assigned to differences in philosophy. Several commentators argue that (a) US law protects competition, not competitors, and focuses on the welfare of consumers; whereas (b) European regulators consult competitors about whether the merged firm is likely to abuse a position of market dominance. In this particular case, UTX was among the competitors reported to have expressed concerns to the Commission.

While there is some truth to this, I would argue that the main differences in regulatory outcome resulted from the different weights placed on domestic and overseas players: after all, GE and Honeywell, the main beneficiary from the merger, are US firms; whereas some of the competitors that would allegedly be harmed by the merger are European. Were the locations of the various player completely reversed (between Europe and the US), would the decisions be reversed too? It is quite possible. In fact, before the EU killed the GE-Honeywell the US Federal Trade Commission (FTC) in 1997 blocked the merger of two Swiss pharmaceutical firms, Ciba-Geigy and Sand, two Swiss pharmaceutical firms.

Global merger policy

In terms of mergers, globalization has raised the bar for a merger to be approved. The idea is simple: in order for a merger to go through, it must be approved by all major competition authorities. In this context, 'major' typically means the USA; the EU; increasingly, China; and finally all jurisdictions where the merging parties have significant interests.

International competition law is a power game: the threat of not following a given competition authority's decision is the threat of not doing business in the respective jurisdiction. If the market in question is small, the threat is small. By contrast, if the market is big, the threat is considerable: not being able to sell in a critical market may render the merger entirely not viable.

In other words, merger policy in the global era is like a **veto game**: it suffices for one of the key players to say **niet** for the merger to fall through. In Cabral (2006), I note the potential inefficiencies created by a game of this sort: it may well be that the total benefit from a merger is positive, but so long as it is negative from the perspective of one country, such merger will not go through.

Joel Klein, then Assistant Attorney for Antitrust at the US DoJ, proposed that an international competition agency be created for the purpose of 'internalizing' the externalities inherent to merger policy. Almost a decade has passed and nothing of that sort has taken place. It is unlikely it will ever take place. In Cabral (2003), I instead suggest an equilibrium solution: To the extent that mergers will continue to be proposed in the indefinite future, the veto game I mentioned above is really a repeated veto game. This is important for, as is well known from repeated-game theory, there may exist equilibria that are more efficient than the repetition of the one-shot equilibrium. In the particular case of merger policy, a more efficient equilibrium consists of competition authorities 'exchanging favors': Country x approves a merger that benefits countries y and z more than it harms country x; and does so on the (equilibrium) understanding that countries y and z will reciprocate in the future.

Abuse of dominant position

I conclude my overview of the three main areas of competition policy by addressing issues of abuse of dominant position. Before getting to the international competition policy issues, it may be helpful to discuss the changing nature of policy making as we go from price fixing to mergers to abuse of dominant position.

A digression: false positives and false negatives

As in any other area of decision-making, errors in competition policy can be classified as

- False positive: a competitive practice labeled anti-competitive
- False negative: anti-competitive practice labeled competitive

Optimal decision-making consists in finding the optimal trade-off between these two types of error. My main claim in this section is that this trade-off becomes increasingly difficult as we move down the list: from horizontal agreements to mergers to abuse of dominant position (e.g. exclusion).

I find it helpful to think about this problem as a series of Venn diagrams. Consider first price fixing. There is a set of market observables (market shares, prices, internal memos, etc.) that is consistent with a cartel being in place; let this be set S1. There is also a set of observables that is consistent with the market being competitive; let this be set S2. Finally, there is a set O defined by the intersection of S1 and S2. O is clearly a non-empty but, I would argue, it is relatively small compared to the size of S1 and S2. This is particularly true when there is internal evidence (memos, board meeting minutes, phone records, etc.) documenting cartel activity. In other words, once it is established that firms did engage in some sort of horizontal practice, then there is little doubt as to its anti-competitive behavior: price fixing laws leave little room for creative interpretation. In this context, the likelihood of a false positive is relatively small.

Now consider merger policy. As before, let S1 be the set of observables that are consistent with the effect of the merger being welfare increasing (whatever the regulator's welfare measure is); S2 the set of observables that are consistent with the effect of the merger being welfare decreasing; and O be the intersection of S1 and S2. I would argue that, for merger policy, the relative size of O is greater. Even if there is little information asymmetry between the merging parties and the regulator, there is still a lot of uncertainty about the actual effects of the merger. This makes merger policy a difficult task.

Finally, consider policy with respect to abuse of dominant position, e.g. predatory pricing. In this case the overlap set O is of maximal size. There are many, many market observables consistent both with a pro-competitive and with an anti-competitive story. A firm may set low prices because it is more efficient or because demand elasticity is high or because it intends to drive a rival out of the market.

Comparative law and policy

Given the confused and confusing nature of most cases of alleged abuse of dominant position, it is not surprising that we find so much divergence across countries. Unlike mergers, where national interests are likely to play an important role, different rulings on dominant firm cases are likely to result from different perspectives on the balance between false positives and false negatives.

Continuing with the case of predatory pricing, consider the similarities and the differences between US and EU policy. One thing that is common on both sides of the Atlantic is the requirement of market dominance: if a clearly articulated case of market dominance is absent, then the case for predatory pricing is also absent. So far, so similar; but when it comes to the actual tests and burden of proof of predatory behavior, the differences are more striking than the similarities. In the USA, pricing below average variable cost (the Areeda–Turner test) is considered a necessary but not sufficient condition. In the EU, by contrast, pricing below average avoidable cost is per se illegal. A clearly articulated argument of recoupment (short-term losses will likely be compensated by long term gains from foreclosure) is considered necessary in the USA but not in the EU. A key quote from US Courts: 'Predatory pricing schemes are rarely tried, and even more rarely successful' (Justice L. Powell on *Matsushita*, 1986). A key quote from EU Courts: 'A dominant undertaking has no interest in applying such prices except that of eliminating competitors' (European Court of Justice on *AKZO*).

This is not to say that national interests do not play a role. For example, it is more than a coincidence that the biggest legal challenges faced by giants such as Microsoft, Google and Intel have come from the EU rather than the USA.

Global effects

Similarly to merger policy, the emergence of a global economy with multiple regulators may result in a situation of over-enforcement. In the case of merger policy, the nature of the static equilibrium of a veto game is to lead to too many blocked mergers, that is, some efficient mergers will be blocked. In the case of abuse of dominant position, we have what Geradin (2009) calls the 'Strictest Regime Wins' problem and the risk of overregulation. This problem is magnified by the possibility of *forum shopping*, the ability of a plaintiff to choose the jurisdiction where to sue. In some sense, forum shopping implies that competition policy is as tough as the toughest policy is. In a world with more than

125 competition authorities, it may not be difficult to find one that is sympathetic to the plaintiff's views.

China

When it comes to the globalization of competition policy, the big elephant in the room is clearly China. In 2007, the country enacted its Anti-Monopoly Law (AML). Unlike most other countries, where the various dimensions of competition policy tend to be housed under the same regulatory roof, the Chinese government enacted various government agencies each with a relatively narrow mandate: (a) the National Development and Reform Commission (NDRC), primarily concerned with price-related anticompetitive agreements, abuse of dominance and administrative monopoly; (b) the State Administration for Industry and Commerce (SAIC), focused on non-price-related anti-competitive agreements, abuse of dominance and administrative monopoly; and (c) the Ministry of Commerce (MOFCOM), whose Anti-Monopoly Bureau is in charge of merger control.

The emergence of China as a competition policy player is important for a variety of reasons. First, the sheer size of the Chinese economy implies that its role simply cannot be ignored. To the extent that jurisdiction is measured by location of economic effects, almost all large-size firms fall under the jurisdiction of the Chinese regulators.

Second, whereas for the past decades global competition policy was largely a game with two players (USA and EU), we now have a much more complex situation. Game theorists are well aware of the important differences between two-player games and games with $n > 2$ players; but practitioners too can appreciate the contrast.

In sum, firms, consultants and regulators who ignore the importance of China do so at their own risk. I next review a few cases that I believe are representative of the emergence of a major new player in global competition policy.

Some recent cases

The P3 Network

In 2014, the world's three biggest container shipping companies (AP Moller-Maersk, Mediterranean Shipping Company and CMA CGM) proposed to form an alliance (the so-called P3 Network). By pooling their 250 ships, they hoped to reduce costs and increase demand in various transatlantic routes. In June of that year, China blocked the agreement. In a statement posted on its website, China's commerce ministry estimated that the alliance would control 47% of container traffic on Asia-Europe routes, 'greatly increasing market concentration'. So, a merger between three western companies, which previously had been cleared by USA and EU regulators, was blocked by China.

The Microsoft–Nokia merger

In 2013, Microsoft offered to acquire Nokia's Devices and Services division, a $7 billion deal. The European Commission and the US DoJ approved the merger. It took several months before China's commerce ministry to give its approval (April 2014); and this was conditional on Microsoft's agreement to license several of its Android-relevant patents on favorable terms. (Several producers of Android phones are located in China.)

The Tetra Pak case

In July 2013, China's State Administration for Industry and Commerce (SAIC) announced that it was launching an investigation against Tetra Pak for alleged abuse of market dominance through tying and discrimination. Tetra Pak was founded in Sweden and is currently headquartered in Switzerland. It is the world's largest manufacturer of aseptic packaging materials (used, for example, in milk cartons). The practice in question is to sell aseptic packaging materials bundled with consumables (a market where Tetra Pak is subject to stiffer competition).

Tetra Pak had been accused (and fined) previously by the European Commission on similar grounds. What made this case particularly notorious is that it was SAIC's first publicly announced investigation into abuse of dominance since China's Anti-Monopoly Law came into force in 2008.

The Qualcomm case

In February 2015, China imposed a fine of $975 million on American chip maker Qualcomm for alleged violations of China's antimonopoly law. Moreover, Qualcomm agreed to offer its licenses (crucial for the operation of third- and fourth-generation smartphones) at much lower prices than it charges in other countries. A legal and trade expert commented that

> This goes beyond Qualcomm; now it's an issue for all major companies, both U.S. and European, that have important patent rights and want to license them and operate in China. (*The New York Times*, 9 February 2015)

Neo-protectionism?

A propos of the Qualcomm case, one of China's regulators hinted that foreign companies cannot expect to simply make money from China without being its 'friend'. This is more than a hint that China's competition policy may be less concerned with the goal of keeping a level playfield and more with fostering its own interests. Specifically, while China is currently one of the world's leading producers of electronic devices, when it comes to semiconductors it is still a major importer ($232 billion in 2013). Hitting Qualcomm and other international companies may contribute to the development of the nation's semiconductor industry: the infant-industry argument meets competition policy.

Going back to the previous merger example, it is noticeable that, the same year that China turned down the P3 network operation, it allowed the merger of China's two largest shipping companies, which, together with the P3 companies, form the world top 5 shippers. And it Is not clear China would show the same zeal in going after TetraPak were it not in direct competition with a Chinese company producing similar products.

Not that the West has much basis to complain: examples of national favoritism are by no means a first. As Kovacic and Hyman (in press) rightly argue, the undisciplined application of agency powers is not something that China invented, rather the emulation of an established regime by a new system.

Concluding remarks

As Aggarwal and Evenett (2013) pointed out,

> The crisis era has seen extensive resort to less transparent — so-called murkier — forms of protectionism and a resurgence of interest in selective government intervention, or industrial policy.

The case of China, the big new player in the global competition policy arena, is not unique, though it is particularly noticeable given the country's size.

In this sense, one of the big challenges for global competition policy is to prevent from turning it into an additional instrument for protection. It would be ironic — sadly ironic — if the great progress toward free trade that has taken place in the context of the WTO and various regional agreements were undone by an increasing protectionist competition policy.

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