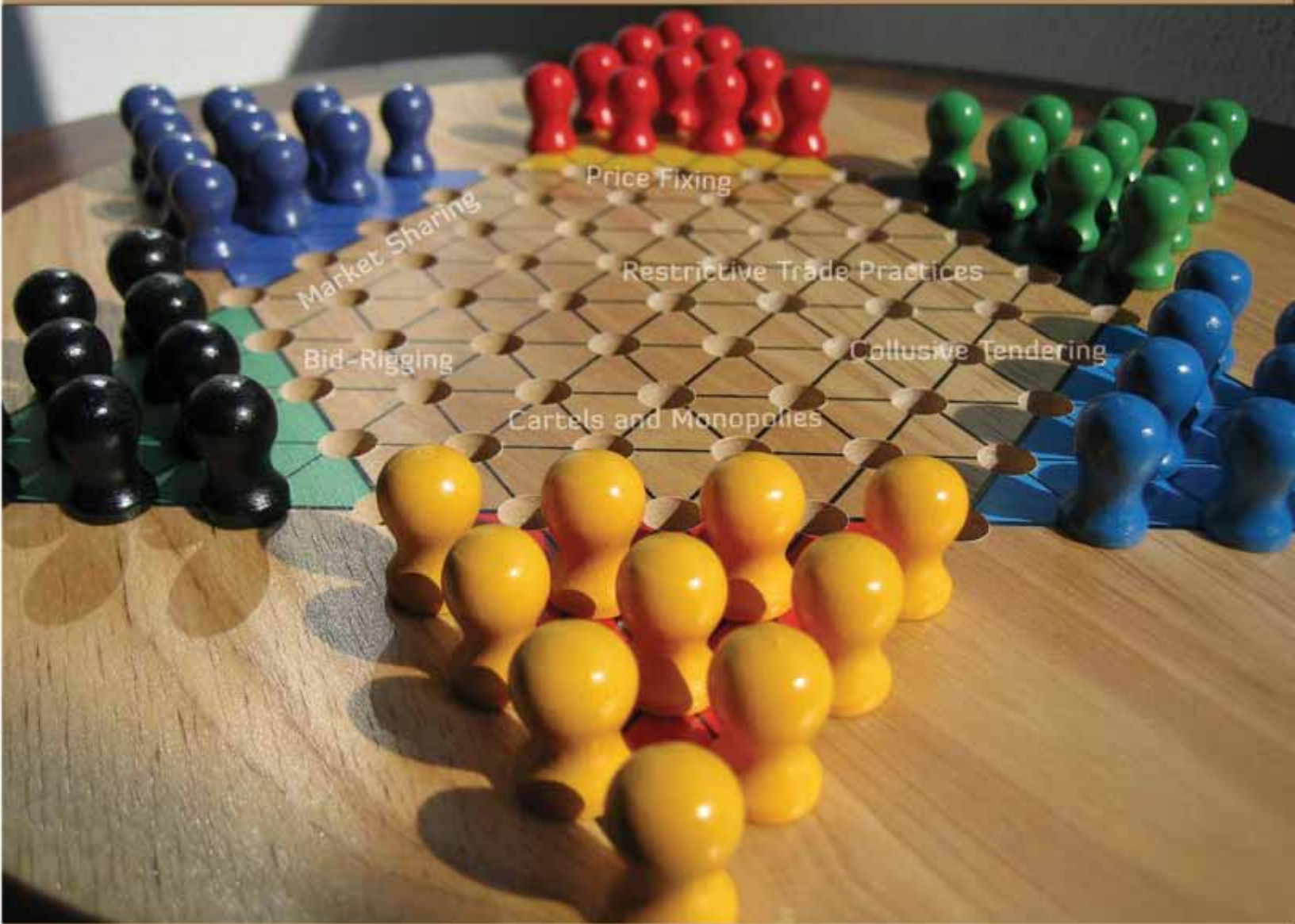


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Cartelization and Market Malpractices



Cartelisation/Tacit Collusion



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What is a Cartel?

Cartel is an agreement between competing firms to control prices or exclude entry of a new competitor in a market. It is an informal organization of sellers or buyers that agree to fix selling prices, purchase prices, or reduce production using a variety of tactics. The word cartelisation refers to agreements between undertakings, decision by associations of undertakings and concerted practices which have as their object or effect of prevention, restriction or distortion of competition within a market, and in particular those which:

- Directly or indirectly fix purchase or selling prices or any other trading conditions;
- Limit or control production, markets, technical development or investment;
- Share markets or sources of supply;

Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at competitive disadvantage;

Make a conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

How a cartel is formed?

The word collusion describes a type of conduct or a form of behaviour whereby decision makers agree to co-ordinate their actions. This in general, would seem to involve two elements:

- The process of communication, discussion and exchange of information with the aim of reaching an agreement
- There are gains in renegeing on the agreement given that the others comply, some kind of mechanism for

punishing such violations and so enforcing the violations.

In real scenarios around globe, it is quite possible that firms could agree to co-ordinate their actions in some way without explicit communication and discussion. For example, it may become tacitly accepted practice in the market to match the price changes of the largest firm. All the firms/entities are aware of 'tacit agreement' or 'conscious parallelism' and no process for reaching on an agreement, is necessary to be followed. However, the second element must always be present, that there are at least short-run gains from renegeing on an agreement. The tacit collusion or cartelisation requires the perception that not to do so would in the end, turn out in unprofitable because of punitive reactions by the other firms.

Types of cartels

Economics science tells us that Cartels usually arise in an oligopolistic industry, where the number of sellers is small or sales are highly concentrated and the products being traded are usually commodities. Cartel members may agree on such matters as setting minimum target prices i.e. price fixing, reducing total industry output, fixing market shares, allocating customers, allocating territories, bid rigging, establishment of common sales agencies, altering the conditions of sale, or combination of a few of these practices. The aim of such collusion (also called the cartel agreement) is to increase individual members' profits by reducing competition.

Basic features of a collusive agreement

The enforceability of collusive agreements by some means can be taken as a necessary condition for their existence. Adam Smith reveals in his book, "Wealth of Nations" that businessmen's meetings even for merriment and diversion, usually



end up with connivance to restrict competition. It is impossible to prevent such meeting, by any law which either could be executed, or would be consistent with liberty and justice, it may be impossible to obtain evidence on what transpired at such meetings. The problem here is that, quite apart from possibility that collusions might be concealed, the observations that firms communicated and appeared to reach agreement need not to imply that collusive outcome was actually achieved, while if collusion is tacit, there will be no evidence of communication and negotiation. The observation of the communication is neither necessary nor sufficient for existence of collusion.

Both the words 'collusion' and 'tacit' are normally interpreted in a different sense. 'Collusion' should, certainly for antitrust purposes, refer to a form of conduct, not the value of an outcome: collusive behaviour might well result in less than monopoly profits. It is tacit not simply because of the absence of a binding (legally enforceable) agreement, but because of the absence of any explicit agreement whatsoever. Explicit collusion would involve the firms in talking to each other, explicitly agreeing to produce half the monopoly output each, and, quite possibly, agreeing also

collecting and disseminating information on costs, outputs, and prices, suggesting price lists (for example, the professional associations for lawyers, doctors and architects publish 'recommended fees scales') and policing the (tacit) agreement. For example, trade association employs individuals who posed as buyers and tried to obtain discounts on prices from sellers suspected of cheating. Trade association may also carry out services such as demand forecasting and capacity planning for the markets as a whole. This can be important both in achieving agreement on prices in the short run, and in preventing the development of excess capacity, which can pose a serious threat to collusion in the long run. At the very least, trade associations often provide the opportunities for the 'meetings of merriment and diversion'.

Difference between a dominant firm and a cartel

Price leadership: It is usual to distinguish between 'dominant firm' and 'barometric' price leadership. In the former, the largest firm first announces price change and the firms then follow within a short space of time; in the latter, some non-dominant firm, which presumably is considered the best at judging the markets conditions, plays this role. In many markets, however, the identity of the firm initiating a price change may vary over time, possibly to avoid the impression that there is a price leader, or to spread more equitably the unpopularity of being the first firm to raise prices. Clearly, the practice of price leadership is a way of solving the problem of choosing one price agreement in the set of possible agreements. If the leader is good at finding mutually acceptable prices, or has the market power to punish deviants from its prices sufficiently, agreement could be entirely tacit. For many writers the 'conscious parallelism' in prices associated with price leadership is very essence of tacit collusion.

Seller Cartels and Buyer Cartels

It is assumed throughout that cartels are designed to eliminate competition among sellers and thereby increase prices. Some cartels, however, eliminate competition among buyers and thereby decrease the prices cartel participants pay. The usual notion of harm from a cartel is the overcharge—what customers paid over and above what they would have paid absent the cartel. The overcharge is calculated by multiplying the cartel's actual sales by an estimate of the cartel's price effect. By increasing prices, a cartel causes customers to reduce their purchases and thereby lose the benefits derived from the purchases they no longer make. A cartel can have umbrella effects as its price increases can lead to increases in the prices of close substitutes. These harms can be estimated, but normally are not.

Legal Framework in Pakistan:

Brief History:

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Pakistan has a long history of having a law to control 'undue concentration of economic power', 'unreasonable monopoly power' and unreasonable restrictive trade practices' since 1971. In 1960s, there was a popular political slogan of 22 families controlling most of the business and wealth of the country.

that deviation by one would be punished by a price war. The fact that the agreement is sustained by threats of market sanctions rather than a binding contract makes it no less explicit, at least in the eyes of antitrust law. Tacit collusion, on the other hand, would involve no explicit agreement but simply the unspoken acceptance by the firms that it was in their best interest each to produce half the monopoly output on the understanding that failure to do so would provoke a price war.

How a cartel works?

It is natural that in real-world markets, many so-called 'facilitating devices' would have been developed. These are arrangements or practices which can be construed as helping firms in at least one of the four steps to staple, successful tacit collusion: defining the possible agreements; focusing upon one; preserving it; and providing for credible effective punishment, it should also be noted that in many cases they would also facilitate explicit collusion, and so their use does not rule out the (possibly concealed) existence of this.

Role of associations in formation of a cartel

Many industries have a central organization which may function fairly innocently, handling public relations at the industry wide level and organizing conventions, trade fairs, etc. However, they may also act as facilitating devices,

monopoly power' and unreasonable restrictive trade practices' since 1971. In 1960s, there was a popular political slogan of 22 families controlling most of the business and wealth of the country. With this background and following the policy of economic development through private enterprise system, a need was felt to keep a balance between the policy objectives of rapid capital formation and economic development, on the one hand, and of social justice and consumer protection, on the other hand. It was felt that a synthesis between these conflicting major policy objectives could be achieved through governmental regulation. Historical experience also indicates that an absolutely unregulated private enterprise system tends to result in concentration of wealth and creation of monopolies and restrictive trade practices which, in so far as they are detrimental to consumer interest, generate in due course general social unrest. In developing countries like Pakistan monopolies emerge as a result of transplantation of modern technology and large-scale production technique to the limited domestic markets characterised by inadequate purchasing power. Public sector policies of restricted licensing for industries also contribute to creation of monopoly like situations. Even in industries otherwise characterised by competition, collusive arrangements at times result in curtailment of output, higher prices and market sharing agreements. Competition, which is the corner stone of the free enterprise system, is thus weakened and public sector interference and regulation becomes necessary to correct the situation.

Experience of the present day advanced countries shows that anti-monopoly legislation is best enacted just when concentration of economic power, monopolies and restrictive trade practices are beginning to take shape. Action at a later stage impairs business confidence and makes the remedy extremely difficult to apply. Keeping these considerations in mind, Government circulated a draft Anti-Monopoly and Restrictive Trade Practices Law for public opinion with the budget for 1969-70. The draft law was widely commented upon by the press, the Chambers of Commerce and Industry and the public and many useful suggestions were received. Taking these suggestions into account, the President and CMLA (General Yahya Khan) promulgated the Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance in February, 1970. The law spelled out the situations which were deemed to constitute undue concentration of economic power, unreasonable monopoly power and unreasonably restrictive trade practices.

In response to political atmosphere and public sentiments just after the promulgation of Monopolies' Ordinance, there was a massive nationalisation of major business sectors in 1972-73 which created state monopolies due to which the Monopolies' Ordinance remained ineffective because state owned/ controlled businesses/corporation were kept out of the jurisdiction of the ordinance. It was in early 1990s when the government framed a new policy of free market economy and privatisation of state owned businesses. Consequently, major industries like cement, automobile, steel, fertilizer besides banks and insurance companies were privatised. Private owners, in haste, tried to make



abnormal profits through formation of Cartel. Therefore, the first cartel investigated by the Monopoly Control Authority was cement cartel formed in 1992. Cement industry happened to be a cartel prone industry, which repeatedly formed cartel in 1999 and 2007-08. Privatised banks along with some other bank also tried to reap abnormal profits through formation of cartels. Whereas cartels were investigated in cellular phone industry, hardware manufacturing industry, sugar industry, food chain industry etc.; it was strongly felt that the Monopolies' Ordinance was not meeting the requirement of redressing present day business distortions as well as comparable with the contemporary laws of other countries. Therefore, a new law, namely, Competition Ordinance, 2009, which was eventually passed by the parliament and named as Competition Act, 2010 was promulgated.

Provisions of Competition Act 2010 relating to Cartel

'Competition Act, 2010' (the Act) aims to provide for a free competition in all spheres of commercial and economic activity to enhance economic efficiency and protect consumers from anti-competitive behaviour. The Act also provides for establishment of Competition Commission of Pakistan (the Commission) to maintain and enhance competition; and for matters connected therewith or incidental thereto.

To have an understanding of the provisions relating to collusive agreements/cartels, definitions of the following few terms may first be kept in view:

'Agreement' includes any arrangement, understanding or practice, whether or not it is in writing or intended to be legally enforceable.

In light of above definition of 'Agreement', a decision of an association can also be considered as an agreement amongst members of the association.

Cartel is mostly considered as a conspiracy of sellers or purchasers against consumers or users because with the force of the agreement or combined strength of the association, the undertakings, otherwise competitors in the same markets, joining hands would collectively gain the position of dominance in the market.

'Goods' includes any item, raw material, product or by-product which is sold for consideration.

'Relevant market' means the market which shall be determined by the Commission with reference to a product market and geographic market and a product market comprises of all those products or services which are regarded as interchangeable or substitutable by the consumers by reason of the products' characteristics, prices, and intended uses. A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the competition are sufficiently homogeneous and which can be distinguished from neighbouring geographic areas because, in particular, the conditions of competition are appreciably different in those areas.

'Retailer', in relation to sale of any goods, means a person who sells the goods to any other persons other than for resale.

'Services' means a service of description whether industrial, trade, professional or otherwise.

'Undertaking' means any natural or legal person, government body including a regulatory authority or body corporate, partnership, association, trust or other entity in anyway engaged directly or indirectly, in the production, supply, distribution of goods or provision or control of services and shall include an association or undertakings.

'Whole seller' in relation to sale of any goods, means a person who purchases goods and sells them to any other person for resale.

Section 4 of the Act is titled as **'Prohibited agreements'**. This section deals with collusive agreements/cartels. This section is reproduced along with a few simple examples in the following paragraphs:

1. No undertaking or association of undertaking shall enter into any agreement or, in the case of an association of undertaking, shall make a decision in respect of the production, supply, distribution, acquisition or control of goods or the provisions of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5 of this Act.
2. Such agreements include but are not are not limited to;
 - a) Fixing the purchase or selling price or imposing any other restrictive trading conditions with regard to the sale or distribution of any goods or provision of any services;
 - o By way of an agreement or a decision, competing undertakings may fix purchase or sale price of a product (e.g. fixing of purchase price of sugarcane by sugar mills or fixing of sale price of cement by the cement manufacturers)
 - o By way of an agreement or a decision, competing undertakings may impose restrictive trading conditions with regard to the sale or distribution of any goods or the provision of any service (e.g. a supplier may fix the minimum or maximum quantity to be sold to a single customer or distributor)
 - b) Dividing or sharing markets for the goods and

services, whether by territories, by volume of sale or purchases, by type of goods or services sold or by any other means;

- o By way of an agreement or a decision, competing undertakings may divide market of a good or service (e.g. they may agree on territory such as Karachi market to undertaking A, Lahore market to undertaking B and Islamabad market to undertaking C)
- o By way of an agreement or a decision, competing undertakings may agree on sale volume (e.g. they may agree on volume such as 30,000 cars by A company, 50,000 by B company and 20,000 by C company)
- o By way of an agreement or a decision, competing undertakings may agree on types of goods or service sold (e.g. edible oil producing companies may agree that company A will produce and sell banaspati ghee and company B will produce and sell cooking oil)
 - c) Fixing or setting the quantity of production, distribution or sale with regard to any goods or the manner or means of providing any services sold;
- o By way of an agreement or a decision, competing undertakings may agree to fix quota of production and sale of a product (e.g. cement manufacturers agree on producing cement according to quota decided by their association)
- o By way of an agreement or a decision, competing undertakings may agree on the manner or means of providing any services (e.g. major practicing audit firms may agree to allocate quota of cases assigned by the FBR for detailed audit by the audit firms)
 - d) Limiting technical development or investment with regard to the production or distribution or sale of any goods or provision of any services;
- o By way of an agreement or a decision, competing undertakings may agree on limiting technical development (e.g. All Pakistan Textile Mills Association may prohibit its member companies from installing new automatic plants for spinning of yarn for a certain period say up to year of 2015)
- o By way of agreement or decision, competing undertakings may agree on limiting investment (e.g. car manufacturers may agree on not making any further investment on expansion of their plants till 2015)
 - e) Collusive tendering or bidding for sale, purchase or procurement of goods or service.
- o By way of an agreement or a decision, competing undertakings may join hands in tendering for provision of any service (e.g. road construction companies may agree to offer their services for different parts of the road and thus not competing with each other through their tenders)
- o By way of an agreement or a decision, competing undertakings may join hands in bidding for sale, purchase or procurement of any goods (e.g. transformer manufacturers may quote the same rate for the same type of transformer thus putting the

procuring authority in a difficult situation to accept or reject any of the bid and forcing it to accept all the bids allocating quantity agreed by each of the bidders)

- f) Applying dissimilar conditions to equivalent transactions with other trading practices, thereby placing them at disadvantage; and
 - o By way of an agreement or a decision, competing undertakings may join hands in applying dissimilar condition to equivalent transaction with other trading parties, thereby placing them at a disadvantage (e.g. cement is sold by cement manufacturers on different prices to different customers or selling major portion of cement to some particular customer causing disadvantage to other customers)
 - g) Make conclusions of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to the commercial usage, have no connection with the subject of such contracts.
 - o By way of an agreement or a decision, competing undertakings make contracts subject to acceptance by the other parties of supplementary obligations which by their nature have no connection with the subject of such contracts (e.g. petroleum distribution companies agree to sell light diesel oil to those customers who also purchase lubricant oil)
3. Any agreement entered into in contravention of provision in sub section (1) shall be void.

The Act has an inbuilt flexibility and business friendly gesture as it has in place a procedure of granting individual or block exemption from the investigation and penal proceedings, if an undertaking or a group undertakings voluntarily apply to the Commission for exempting an agreement falling under section 4, to which they are a party, if they prove that such particular practice or an agreement, substantially contribute to:

- o Improving production or distribution (e.g. two or more pharmaceutical companies enter into an agreement for research of a medicine to cure diabetes)
- o Promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit (e.g. two or more cement manufacturers enter into an agreement to invest in coal mining for conversion of their production process to coal fuel and thus conserve their fuel expenses and pass on the benefit of cheaper production to consumers).
- o The benefits of that clearly outweigh the adverse effect of absence or lessening of competition (e.g. textile weaving companies agree to jointly install a finishing and dyeing plant to produce bed sheets of export quality and thus capture a sizeable export market benefit of which are more than the negative effect on employment of the individual party to the agreement).

Section 34 of the Act empowers the Commission, for reasonable grounds to be recorded in writing, to authorize an officer to enter and search any premises for the purpose of enforcing any provision of the Act.'

Section 35 of the Act says that 'in the event that an undertaking refuses without reasonable cause to allow the Commission to exercise the powers contained in section 34, an investigating officer of the Commission may by written order, signed by any two Members, enter any place or building by force, if necessary.'

Under section 38 of the Act the Commission may impose a penalty for contravention of section 4 at the following rates:

- o Up to **75 million rupee** or up to 10% of the annual turnover of an undertaking
- o Up to **1 million rupee** for non-compliance of any order, notice or requisition of the Commission
- o Up to **1 million rupee** for failure of an undertaking to supply a copy of the agreement or any other documents and information.
- o Up to **1 million rupee** for every day after the first day of the recurring violation.
- o Failure to comply with an order of the Commission shall constitute a criminal offence punishable with imprisonment for a term which may extend to **1 year** or with a fine which may extend to **25 million rupees**.

Section 39 of the Act is another land mark provision to effectively deal with the cartels. This section provides for relief and zero or lesser penalty for cartel members who opt to be whistle blower and approach to the commission with evidence about the formation of cartel. Under this section 'the Commission may, if it is satisfied that any undertaking which is a party to a prohibited agreement and is alleged to have violated the prohibition prescribed in this Act, has made a full and true disclosure in respect of the alleged violation, impose on such undertaking a lesser penalty as it may deem fit, than that provided in section 38.'

Conclusion

Although Pakistan has in place a very good piece of legislation to tackle with the menace of cartels, its effective implementation/enforcement needs public awareness and support. The important lesson of history is that interest of the consumers should not be sacrificed at the altar of the free market economy. There is a need to construct a balance between free market economy and consumer welfare. The Act does not put a cap on bigness and growth of the business houses; however, it prescribes a mechanism to regulate the practices which harm free inter play of market forces and create artificial dominance to abuse the interest of consumers or users. Political governments must realize that if the business leaders are left free and their economic behaviours are not monitored and regulated they would not stop fleeing money from the pockets of general public, eventually inviting public anger and social unrest. Therefore, strong political will, on the one hand, and active consumer association, on the other, must play their role in mitigating the ill effects of cartel by strengthening the hands of the enforcement body i.e. the Competition Commission of Pakistan.

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