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A Developing Country Perspective

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Abstract

Export cartels are exempted from the competition laws of most countries. While some scholars and several WTO members have recently condemned such cartels, others have argued that they allow efficiency gains that actually promote competition and trade. This paper examines the various issues involved, with special reference to developing countries and to recent discussions on trade and competition policy. After summarising the contending views on export cartels, and also the scanty theoretical literature on the subject, it reviews the treatment of such cartels in various jurisdictions and the limited empirical evidence that is available on their prevalence, efficiency justifications, and effects on international trade. Insights from economic theory are then applied to the arguments for and against export cartels, suggesting criteria that could help to determine their validity and an importing country's best response. The paper concludes that while importing countries should evaluate foreign export cartels under a "rule of reason", most of them will be constrained by a lack of technical expertise and limited enforcement capacity. It suggests a novel approach, based on parallels with anti-dumping procedures, which would strengthen their hands.

Keywords: antitrust, competition policy, trade negotiations, WTO.

JEL Classification: F13, F14, L41.

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I. Introduction

International cartels have attracted much attention in recent years, with competition (antitrust) agencies in the European Union and the United States having successfully prosecuted over forty such cartels during the 1990s. Studies commissioned by the OECD (2003a, Part II), the WTO Secretariat (Evenett, 2003), and the World Bank (revised version in Levenstein et al, 2003) summarise the statistical evidence generated by these cases, and present estimates of the losses incurred by consumers in other countries, especially developing ones, as a result of the cartels' activities. And yet, despite the growing concern over international cartels comprising firms based in different countries, much less attention has been paid to export cartels based in only one country and implicitly or explicitly exempted from its competition laws. The three international studies cited above, for example, mentioned them only in passing. Many antitrust scholars as well as country representatives have recently called for abolishing such exemptions in the context of discussions at the WTO on a possible agreement on competition policy, but there have also been forceful dissenting views claiming that export cartels actually promote efficiency, trade, and competition. All these conflicting views, as we shall see below, have been based on simple assertions about the benign or malign effects of export cartels, without adequate theoretical or empirical foundations.

This is not a happy state of affairs. Even though, after the failure of the Cancun Ministerial conference, competition policy now appears to be a moribund issue at the WTO, inexperienced competition agencies in the dozens of countries that have recently enacted competition laws will need to understand the impact that foreign export cartels might have on their economies. Knee-jerk condemnation, or for that matter, unquestioning acceptance of efficiency arguments, will encourage distortions in international trade, whether through the actions of private parties or of governments trying to oppose them. This paper explores the issues involved. Section 2 summarises the contending views on export cartels, and also the scanty theoretical literature on the subject. Section 3 reviews the exemptions granted to export cartels in various jurisdictions and the limited empirical evidence that is available on their prevalence, efficiency justifications, and effects on

international trade. Section 4 recounts the efficiency claims made by one U.S. export association that ran afoul of antitrust agencies in four different jurisdictions during the 1990s, and the reasons given by those agencies for rejecting them. Section 5 applies basic economic principles to the efficiency arguments of the preceding sections, suggesting criteria that could help to determine their validity and an importing country's best response. On the basis of this analysis, Section 6 concludes that while importing countries should evaluate foreign export cartels under a "Rule of Reason", most of them will be hampered by their lack of technical expertise and limited enforcement capacity. It suggests a novel approach, based on parallels with anti-dumping procedures, which would strengthen their hands.

2. Contending Views

A. Academic Arguments

Economic theory has long recognised that restricting exports via cartelization is an optimal policy for a country with market power in foreign markets, but this is tempered by two considerations. First, consumers in the exporting country are adversely affected, unless there is no domestic consumption of the exported product, or cartelization of export sales can be separated from competition in the domestic market.[1] Second, such a policy is mutually welfare-reducing if practised by several countries simultaneously. The case for rules governing export cartels should therefore be at least as strong as for other "beggar-thy-neighbour" trade policies such as tariffs and export subsidies, which are the staple fare of trade agreements. Yet, economic theorists have paid little attention to this issue, despite an outpouring of research on the interaction of trade and competition policy in the context of discussions at the WTO.

Several leading international antitrust and trade policy specialists have, however, recently called for a WTO agreement on competition that would incorporate the fundamental principle of National Treatment (NT), or non-discrimination between domestic and foreign parties. They see abolition of

[1] For formal oligopoly models, see Auquier and Caves (1979), Dixit (1984), and Brander and Spencer (1984). This is related to a much older argument according to which a country with monopoly power in the export market for a product, but with competitive producers who are unable to exploit it, can use cartelization as an alternative to an export tax in order to improve its terms of trade by restricting exports.

export cartel exemptions as the most obvious benefit arising out of the adoption of this principle. For example, Trebilcock et al (2002, p.675), regard the exemption as "myopic", in that although it might enhance a country's national income in the short run, it encourages "a downward spiral or beggar-thy-neighbour dynamic through reciprocal measures that in the long-run reduce both national and global welfare". Removal of these exemptions, according to them, would be the easiest application of the NT principle. Guzman (2003, pp.40-42), while recognizing that de jure NT in an antitrust statute does not preclude de facto discrimination in its enforcement, acknowledges that NT would at least get rid of the export cartel exemption. Hoekman and Mavroidis (2003, pp.19-21) go further, calling for an outright ban on export cartels by developed countries, supplemented by a commitment by them to devote resources to active prosecution of their own firms who might violate the ban. This would allow developing countries that lack extra-territorial enforcement capability to "outsource" enforcement, in exchange for which they could offer greater market access to developed-country exports.

On the other hand, Holmes et al (2003, p.69) remind us that "Domestic competition laws are jurisdictional with regard to effects on the domestic territory …. As such, they act to address both foreign and domestic practices, but only as these practices affect competition upon the domestic market. Since national competition laws are not drawn to treat the external … effects of domestic policies, territories stating explicit "exclusions" from treating the external effects of domestic practices (export cartels) are really no different from the territories that do not state such an explicit exclusion." They further point out that GATT Article III (concerning NT) is limited to non-discrimination between domestic and foreign goods competing on the member's *internal* market. "This means that [NT] imposes no obligation upon a Member to consider the manner in which domestic laws affect the external sale of domestic products." (ibid, n.22). Incorporating NT into a competition agreement would not, on this reading, result in export cartels becoming subject to the competition laws of their home jurisdictions; much more specific language would be required.

Yet other scholars oppose a blanket prohibition of export cartels. Singh (2003, p.29) objects to NT itself, on the grounds that developing countries need a lax competition policy to enable their firms to reap economies of scale to compete on an equal footing with multinational corporations. He argues that developed countries should on their own initiative crack down on the anti-competitive activities of firms based in their jurisdiction that have a harmful effect on developing countries, without expecting the latter countries to take similar actions against their own firms. More pragmatically, Scherer (2000, pp.395-403) acknowledges that most countries would be reluctant to prohibit cartels in commodities which are major sources of export earnings, and recommends that any agreement should allow each country to exempt export cartels (or participation in international cartels) in upto three industries, defined at the four-digit level of the Standard International Trade Classification. This proposal is deliberately biased in favour of developing countries, whose exports are typically concentrated in a narrow range of commodities. He argues that their industrialization would be facilitated by an agreement that would discourage cartelization by suppliers of raw materials, equipment and technology based in developed countries. But he also makes a qualified case for permitting developing countries to maintain cartels in industries producing manufactured exports, to allow for economies of scale, coordinated marketing, financing of technology development, and even coordinated export pricing so as to avoid charges of dumping in foreign markets. Finally, Davidow and Shapiro (2003, pp.66-67), while supporting a WTO agreement on competition policy, point out that outright condemnation of export cartels is uncalled for, on the grounds that they may conduce to cost reduction and risk sharing, and that a cartel's market share in its export market would be much smaller than in the domestic market.

B. Country Positions

The lack of consensus in the academic community is reflected in the contending positions of WTO members. In submissions to the WTO Working Group on Trade and Competition Policy, several WTO members had criticised the exemption of export cartels in national competition laws. According to the

EC, such cartels "had a clear distortionary effect on international trade as well as a harmful impact on development", while the Japanese submission went further:

> *Since export cartels usually have a small impact on domestic markets, competition authorities, in general, are not in a position to regulate them. Even if they are, there still remains the problem of whether they are able to regulate, under national laws, practices that do not necessarily affect their domestic market. In addition, it is generally difficult for the authorities of importing countries to regulate such cartels. Nevertheless, export cartels do distort trade. It would be most significant, therefore, under such circumstances, if the WTO, a multilateral body for international trade, can consider a common regulation against them, including even their prohibition.*[2]

Significantly, the EC and Japan were the major proponents of a WTO agreement on competition policy. In practical terms, the EC position did not amount to much, because it did not envisage an agreement that would provide for anything more than consultations and voluntary cooperation with the authorities of other jurisdictions, while NT would continue to exclude such cartels from their own laws (Holmes et al, 2003).

Several developing countries, including those opposed to an agreement, joined in the condemnation of export cartels. Trinidad and Tobago (on behalf of CARICOM, the Caribbean Economic Community) as well as Brazil drew attention to the harm that they inflicted, especially on developing countries.[3] While expressing similar views, Thailand, India, China, Indonesia and Egypt invoked the principle of "Special and Differential Treatment" to argue that developing countries should be allowed to continue to exempt their export

[2] WTO documents WT/WGTCP/M/12 (Minutes of the Working Group meeting of 2-3 October 2000), paragraphs 10 and 25; and WT/WGTCP/W/156 (Communication from Japan, 19 December 2000).

[3] See, respectively, WT/WGTCP/M/12 (Minutes of the meeting of 2-3 October 2000) and WT/WGTCP/M/22 (Minutes of the meeting of 26-27 May 2003), paragraph 25.

cartels, on the grounds that they were made up mainly of smaller firms, while requiring developed countries to abolish their exemptions.[4]

The United States, however, argued that export cartels can result in efficiency benefits that promote trade, and in these cases "such arrangements clearly had pro-competitive effects. Care was therefore required in discussing arrangements currently characterized as export cartels which did not, in fact, necessarily have the same effects as hard core cartels."[5] "Hard core" cartels, according to the widely followed definition in the 1998 OECD Recommendation that called for international cooperation to deal with them, are anticompetitive agreements, arrangements or concerted practices by competitors to fix prices, rig bids, restrict outputs, or share markets. However, the same Recommendation specifically excluded "agreements, concerted practices, or arrangements that *i*) are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies, *ii*) are excluded directly or indirectly from the coverage of a Member country's own laws, or *iii*) are authorised in accordance with those laws" (see OECD 2003a, Annex B). Because export cartels, as I shall show in the next section, are exempted one way or the other in most OECD countries, they would fall under one or more of these clauses.

A catalogue of exemptions from national competition laws compiled by the WTO Secretariat found that that, despite the concern expressed by several members regarding exemption of export cartels, "only one country, namely Japan, is noted as having been identified (*sic*) a specific exemption for export cartels in its national legislation".[6] This list was gleaned from members' own submissions describing their competition laws, and evidently they were reluctant to disclose exemptions that could work against their trade partners.

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[4] See, respectively, WT/WGTCP/W/213/Rev.1 (Communication from Thailand, 26 September 2002); WT/WGTCP/W/216 (Communication from India, 26 September 2002); China: WT/WGTCP/M/19 (Minutes of the meeting of 26-27 September 2002), paragraph 78; Indonesia: id., paragraph 53; Egypt: WT/WGTCP/M/22 (Minutes of the meeting of 27-27 May 2003), paragraph 33.

[5] WTO document WT/WGTCP/M/18 (Minutes of the WTO Working Group meeting of 1-2 July 2002), paragraph 44. The point was reiterated by the United States in its Communication of 15 August 2002 (WT/WGTCP/W/203, at B.7), and at the meeting of 20-21 February 2003 (WT/WGTCP/M/21, paragraph 37).

[6] WT/WGTCP/W/172, 6 July 2001 ("Exceptions, Exemptions and Exclusions Contained in Members' National Competition Legislation"), para 14. Even WTO Secretariat's most recent survey of national competition laws only refers to the earlier document for information on exemptions (WT/WGTCP/W/128/Rev.3, 27 November 2003).

With the members of the OECD, representing the world's dominant economies, skirting the issue; the U.S. openly questioning its relevance; the EC offering only voluntary cooperation as developing countries and antitrust scholars began to call for prohibition; and the Secretariat unable to compile a comprehensive list, export cartels seemed to be getting sidelined at the WTO discussions. It is not surprising therefore, that on the eve of the Cancun Minsterial, some forty developing countries sought clarifications on, inter alia, whether the definition of hard-core cartels would cover export cartels.[7] As the conference ended in failure, the issue remained unresolved.

To sum up, many countries, like most of the antitrust scholars and economists cited above, saw export cartels only in a competition-restricting role no different from that of any other cartel. Others saw the possibility of competition-enhancing efficiencies; others yet saw virtue in their own cartels and evil in others. All these opinions were expressed only in passing, in the course of much broader commentaries on trade and competition policy. Perhaps in consequence, the contending views took the form of assertions. No serious empirical or theoretical arguments seem to have been entered at any stage of the debate, in contrast to the several voluminous studies of international cartels. The remainder of this paper represents an attempt to sort out the issues involved.

3. Prevalence and Legal Treatment

How widespread are export cartels, and how are they dealt with in national competition laws? The answers to these questions turn out to be related. Some jurisdictions provide for specific exemptions, requiring notification or registration with a government agency. In such cases, some information about their prevalence and claims of efficiency becomes available. Elsewhere, conduct relating to exports is excluded from the coverage of the national law, either explicitly, or implicitly by jurisdiction being limited to activities that affect competition in the domestic market. Consequently, there is little information about the existence of export cartels. As the quotations above from Holmes et al (2003) suggest, an implicit exclusion is as good as an explicit one as far as

[7] WT/MIN(03)/W/41 dated 4 September 2003 (Communication from 16 developing countries, with

action by the home authorities is concerned. A recent OECD background note on exclusions from competition laws makes a similar point, suggesting that the explicit provisions for export cartels "are better regarded as clarifications rather than exclusions" (OECD 2003b, p.3). Nonetheless, it is useful to get a sense of where such provisions exist and how they work, particularly in light of the WTO Secretariat's inability to compile a list.

Evenett et al (2001) and OECD (2003b) between them list fifteen countries whose competition laws explicitly or implicitly exclude export cartels. Of these, Australia and New Zealand require only notification; Japan, Spain and the United States require authorization; in Canada, Greece and Mexico the exclusions are explicit; elsewhere it is implicit. Almost all the countries in these two compilations are developed countries or economies in transition, and so a couple of additional examples from developing countries might be helpful. In the next section, I shall have occasion to refer to the new competition laws in India and South Africa in respect of their treatment of *foreign* export cartels. Here it is worth mentioning that both allow exemption of their own. Section 3(b)(i) of the 1998 South African Competition Act lists "maintenance or promotion of exports" as one of the possible grounds for granting an exemption for a restrictive agreement or practice. Section 5(ii) of India's 2002 Competition Act is a more far-reaching 'carve-out': "Nothing in this section [on anti-competitive agreements] shall restrict … the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export."

Export cartel exemptions in the major industrial countries were implicitly the targets of the complaints by other WTO members reviewed in the preceding section, and this calls for more detailed investigation of their laws. The European Union operates what I have called an implicit exclusion. Article 81(1) of the EU Treaty prohibits only those cartels "which may affect trade between Member States and have as their object or effect the prevention, restriction or distortion of competition within the common market". The UK has now moved in the same direction. Formerly, the 1976 Restrictive Trade Practices Act

Bangladesh signing on behalf of the group of Least Developed Countries).

provided a specific exclusion for agreements pertaining to exports, and also a so-called "gateway" through which a restrictive agreement could be condoned if it could be demonstrated that removal of the restriction would cause a substantial reduction in exports. As one commentator put it, "Where agreements have an exclusively overseas application, then neither the 1976 Act nor the Competition Act 1980 will apply at all." (Frazer 1992, p.239). Both Acts have now been repealed, and Chapter I of the 1998 Competition Act limits the cartel prohibition in language identical to the EU Treaty's, substituting "within the United Kingdom" for "between Member States" and "within the common market". Evenett et al (2001) note that Germany also recently abolished its registration requirement for export cartels. Implicit exclusion is now the norm in the EU: "In principle, an export agreement amongst UK producers (or groups of producers in other single member states) exclusively to increase exports to non-EU markets is beyond the reach of Article 81. For the same reason a similar agreement amongst enterprises in several member states dealing solely with exports from the Community would fall outside the scope of the existing antitrust provisions, although hitherto no test of such a case has been made" (Utton 2003, p.55).

In the U.S., export cartels are shielded from antitrust action by three statutes, two of which involve a registration procedure. Consequently, they are more visible to foreign competition agencies (and private researchers). The 1918 Webb-Pomerene Act (WPA) gives registered export associations qualified immunity from Section 7 of the Clayton Act (which regulates mergers) and the Sherman Act, which otherwise prohibits "Every contract, combination … or conspiracy in restraint of trade or commerce among the several States, *or with foreign nations*" (emphasis added). The WPA covered only associations engaged solely in export trade, and excluded the export of services. It also left open the possibility of challenges by the government or private parties on the grounds that the association had exceeded the scope of its immunity, and this undermined its popularity (Guzman, 1998, p.1534).

The Export Trading Companies Act (ETCA) of 1982 went some way to overcoming these limitations. It enables entities (whether ETCs or not) to apply for a Certificate of Review (CoR) for specific export-related activities, including

services, even if exports constitute only a small share of their business. A CoR is granted only if the proposed activities do not substantially lessen competition in the U.S., restrain the export trade of another U.S. exporter, unreasonably affect prices in the U.S., or result in the resale in the U.S. of the exported goods and services. The CoR provides virtual immunity from prosecution by the government, substantial procedural advantages in cases filed by private plaintiffs on the grounds that these conditions have not been met, and actual rather than treble damages if an adverse judgment results in the latter case.[8]

In its promotional literature, the U.S. Office of Export Trading Company Affairs (OETCA), the department that administers the ETCA, lists several advantages that export joint ventures afford to their members.[9] These include cost reducing measures such as joint market research, trade shows, advertising, financing, servicing, and training activities; as well as the ability to offer a full line of products and to meet foreign non-tariff barriers involving labelling, packaging and quality control requirements. OETCA also offers as possible advantages the scope for joint bidding, market sharing, and coordinated pricing to avoid rivalry between U.S. firms – in short, the elements of a hard-core cartel that would attract sanctions under antitrust law. Similar advantages remain available under the WPA, although the ETCA has further reduced its popularity: as of June 2003, only twelve Webb-Pomerene Associations were registered with the FTC.[10]

The WPA and ETCA protect U.S. firms from antitrust prosecution provided that they register themselves or obtain a CoR, respectively. A third protective statute, the Foreign Trade Antitrust Improvements Act (FTAIA) was legislated along with the ETCA in 1982 and covers conduct by other firms as well, but its ambiguous wording and confusing legislative history have given rise to variant interpretations. In recent years, some foreign plaintiffs have actually succeeded in using the FTAIA to win claims against a U.S. exporters in two federal appeals courts, while other courts have dismissed similar claims

[8] ETCA "Guidelines for the Issuance of Export Trade Certificates of Review" www.it.doc.gov/td/oetca/guidelines.html, accessed on August 9, 2003.
[9] "Team Up for Exporting", www.it.doc.gov/td/oetca/teamup.html, accessed on August 9, 2003.
[10] www.ftc.gov/os/statutes/webbpomerene, last accessed on December 6, 2003.

(Mehra 2002; Levenstein et al 2003). The situation is likely to remain unclear until appeals are decided by the U.S. Supreme Court.

The relative importance of the cost-reducing versus monopoly-enhancing objectives of an export cartel is crucial from the perspective of the importing countries, and on this count empirical evidence pertaining to the U.S. export associations is mixed. An early study by Larson (1970) found that most Webb-Pomerene Associations were dominated by large producers and had formed in industries that were highly concentrated. Those composed of small firms and/or in less concentrated industries generally either did not form common sales agencies (CSAs), which he regarded as essential to obtaining economies of scale, did not export, or did not function at all. He concluded that the Act had little impact on exports, but a substantial anti-competitive effect on the domestic market, and recommended its repeal. Similarly, Scherer (1994, p.45), citing a 1967 FTC study of Webb-Pomerene Associations, argued that "there are grounds for doubting whether cost saving has been the main consequence of the … associations actually formed. The Webb-Pomerene groups have been shown to comprise mainly large firms, not their smaller bretheren; and a disproportion have originated in relatively highly concentrated U.S. industries."

Somewhat contradictory evidence comes from a series of papers by Dick (1992a, 1996a, 1996b), who used econometric techniques to analyse the characteristics of over a hundred Webb-Pomerene associations. He found that that they were associated with industries that were *less* concentrated but with a higher ratio of fixed capital to output, suggesting that scale economies were a major consideration in their formation. However, those involving a CSA were more likely to restrict exports and raise prices, while those without such centralized arrangements were likely to promote exports through exploiting economies of scale in marketing. The likelihood of a CSA, in turn, was higher in cartels with *fewer* members, producing homogeneous products in which the U.S. had a high share of the world market. Independently, price-fixing was also more likely to be stated as the cartel's primary objective the larger the U.S. market share and the industry's capital intensity. CSAs increased cartels' longevity, but price-fixing tended to decrease it.

Considerations of confidentiality restricted Dick's data to cartels that operated between 1918 and 1965. More recent, but less rigorous, evidence comes from a 1993 OECD study of 94 US export trading companies which showed that "only four engaged in foreign government liaison, nine in joint promotion activities, four in promotion of a U.S. region, four in warranty service, and seven in project coordination. Thirty-seven fixed prices, thirty-six coordinated bids, and fourteen allocated customers." (Scherer 1994, p.45). In other words, most of them acted as hard-core cartels.

Japan also used to give explicit exemption to export cartels. A study by Nagaoka (1998) showed that 200 or more such exemptions were in force each year throughout the 1960s. The numbers declined appreciably over the next two decades, but remained above 50 until 1988, with many cartels being organised to administer Voluntary Export Restraints at the behest of importing countries. During the 1990s exemptions were scaled down drastically, and according to the latest (2002) WTO Trade Policy Review for Japan, there are none in force at present.[11] Dick (1992b) examined the Japanese export cartels in their heyday, and found that most of them did not appear to affect export prices or volumes; if anything, they contributed to cost reduction and quality assurance in some cases.

The available evidence on export cartels, then, is both dated and inconclusive, and often relies excessively on their own stated objectives. In order to provide a clearer focus with more recent case-study evidence, and to get a sense of how competition authorities in *importing* countries might respond, I recount the attempts by one particular Webb-Pomerene CSA, the American Natural Soda Ash Corporation (ANSAC), to break into three different markets and retain its dominant position in a fourth. I review the efficiency arguments made by ANSAC and the reasons given by the competition agencies of the importing countries for rejecting them. In doing so, I shall ignore the many other procedural and jurisdictional issues as well as allegations of predatory pricing that were raised but not pursued in some of the cases.

[11] WT/TPR/S/107 ("Trade Policy Review Body - Trade Policy Review - Japan - Report by the Secretariat"), paragraph 65.

4. A Case Study and its Lessons

Soda ash, or sodium carbonate, is used in the manufacture of glass, detergents, and paper. It can be produced by either of two processes: the synthetic Solvay process, developed in the nineteenth century and now used worldwide, or by the processing of trona ore, which is the method used by all but one of the U.S. producers. The latter process is far more economical in terms of both energy and labour inputs, but the bulk of US trona deposits are located far inland, in the states of Wyoming and Colorado, making transport costs an important determinant of international competitiveness. US production consistently exceeds domestic consumption; hence the attempts of the American industry to break into foreign markets. The American soda ash industry was a prime candidate for cartelization. It produced a non-durable homogeneous product with a few producers and a significant share of the world market. In addition, the firms were located in close proximity to each other and the ore deposits, and therefore had similar costs of production and transportation.[12] In 1983, the six American producers formed ANSAC, an export trading company registered under the Webb-Pomerene Act.

A. European Community[13]

ANSAC's first encounter with foreign competition law occurred in the late 1980s. The individual American soda ash firms' attempts to supply the EEC had received a setback when price undertakings and anti-dumping duties were imposed in 1983, resulting in a sharp decline in sales, and the exit of all but one of them from the European market. Routing exports through ANSAC would mean confronting the clear prohibition of Article 85(1) (later renumbered 81(1) and quoted in the preceding section). In the 1988 *Wood Pulp* decision, the European Court of Justice had dismissed the American defendants' contention that their registration as a Webb-Pomerene association gave them immunity on the basis of the "act of state" doctrine. The Court rejected this defence,

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[12] Conforming to the predictions of cartel theory, the sole firm using a different raw material (lake brines) and in a different location (California) recently gave notice of withdrawing from ANSAC because it had an advantage in proximity to west coast ports (USGS *Minerals Yearbook 2002*, p.71.3,accessed from: http://minerals.usgs.gov/minerals /pubs/commodity/soda_ash/ sodamyb02.pdf).

[13] This account is based on Commission Decision 91/301/EEC, *Official Journal of the European Communities* L152, 15 June 1991, pp.54-60.

"asserting that Webb-Pomerene associations are only *allowed* and not *required* by U.S. law, and therefore the act of state non-interference principle did not hold".[14]

With this precedent, ANSAC attempted a different tack. In December 1988, it notified its arrangements to the Commission to clear the way for its members to sell jointly rather than severally. The Commission had, in its Regulation 17 of 1962, set up a system for examining agreements that might violate Article 85(1). This allowed the parties to apply for negative clearance or alternatively an exemption under Article 85(3) (now 81(3)), which permits what amounts to an efficiency defence of a restrictive agreement, subject to the conditions that it allow consumers a fair share of the resulting benefits, does not impose restrictions that are unnecessary to the efficiency objective, and does not allow for substantial elimination of competition. In attempting to meet this standard, ANSAC contended that its proposed entry into the EEC would enhance competition. It also claimed that it was not a cartel, but a dedicated sales organization, and so 85(1) would not apply. Alternatively, it sought an exemption under 85(3) on the grounds that it would be able to achieve economies of scale in avoiding the duplication of overhead costs of setting up separate distribution facilities; change the oligopolistic structure of the EEC market; and offer its customers greater security in supplies and lower prices. In the course of the hearing, a senior ANSAC official also demonstrated that the lower distribution costs would, after calculating back from the ex-warehouse price, allow it to show a higher nominal ex-works price than an individual American producer, enabling it to escape the charge of dumping.[15]

Rejecting these arguments, the Commission held that even though ANSAC was constituted as a separate corporate entity, its membership agreement had as its object and likely effect the restriction of competition, bringing it under Article 85(1). Past sales activities showed that the individual producers could compete in the European market, and should be able to do so

[14] As paraphrased in Scherer (1994), p.48.

[15] Dumping occurs when a product is exported at a price that is lower than the price charged in the exporter's domestic market, or below a constructed measure of costs. This comparison creates a difficulty when prices are quoted at the point of delivery, because comparability requires that the export price be ex-works (that is, at the point of production). Lower transport costs would enable an exporter to show a higher ex-works price to challenge an accusation of dumping.

again, as the major obstacles they faced had been removed: anti-dumping duties had expired while the case was pending, and exclusionary practices of the major European producers were simultaneously being prohibited.[16] ANSAC's proposed entry would bring only one new supplier into the market, resulting in a different outcome as compared to a situation in which some or all of its members entered individually. It would be more likely to collude with existing suppliers, and would foreclose the possibility of European buyers obtaining their supplies from individual ANSAC members. ANSAC's demonstration that the price would actually be higher than that of its individual members showed that any economies of scale obtained in shipping were not going to be shared with European consumers, as required for an exemption under 85(3). Nor was the joint marketing arrangement necessary for the economies claimed for collective distribution, for the Commission had indicated that it would be prepared to give an exemption to an agreement limited to storage and transport facilities. In conclusion, the ANSAC agreement infringed Article 85(1), an exemption under 85(3) was refused, and the agreement could not be implemented in the EEC. But the story had a happy ending, at least for ANSAC and for European consumers: The U.S. producers subsequently formed another Webb-Pomerene association, the American-European Soda Ash Shipping Association (AESASA), presumably satisfying the Commission's requirements, specifically for exports to the EEC.[17]

B. India

India's Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 (now replaced by the 2002 Competition Act) borrowed heavily from the UK Restrictive Trade Practices Act of 1956. Certain types of agreements, including those relating to price fixing and market sharing, were listed in Section 33 of the Indian Act, and were required to be registered with the MRTP Commission.

[16] The Commission simultaneously imposed substantial fines on the major European suppliers, ICI and Solvay, for exclusionary conduct in giving rebates to their customers that would deter them from obtaining supplies from rival suppliers. The three Decisions (pertaining to Solvay, ICI, and ANSAC) contained substantially identical paragraphs describing the product, the market, and the competitors. ICI and Solvay appealed and got the decisions annulled on procedural grounds in 1995 by the Court of the First Instance, and the Commission's appeals were dismissed in April 2000 by the European Court of Justice. However, the Commission readopted the original decisions, almost verbatim, in December of that year: see *Official Journal* 2003 L10, pp.10-50.

[17] The annual reports of ANSAC and AESASA, with their almost identical membership lists, are available at www.ftc.gov/os/statutes/webbpomerene, accessed on August 6, 2003.

Section 37 empowered the Commission to inquire into any restrictive trade practice (RTP), whether registered or not, and order its discontinuance or modification if it were found to be "prejudicial to the public interest". According to Section 38, an RTP would be "deemed to be prejudicial to the public interest" unless the Commission was satisfied that one or more of several specified circumstances (referred to in case law, as in the UK, as "gateways") prevailed. It also required the balancing of these circumstances against any harms caused by the RTP. Although "efficiency" was not explicitly one of the gateways, Section 38(b) allowed the respondent to argue that removal of the restriction would deprive buyers of "specific and substantial benefits", while a minimal effect on competition could be pleaded under 38(h).

In September 1996, ANSAC attempted to ship a consignment of soda ash to India. The Alkali Manufacturers Association of India (AMAI), whose members included the major Indian producers, filed a complaint with India's MRTP Commission, alleging infringement of several sections of the MRTP Act, including cartelization. The Commission imposed an ex parte interim injunction on ANSAC, restraining it from cartelized exports to India. In June 1997, the Commission rejected ANSAC's petition for vacating the injunction.[18] Quoting from the ANSAC membership agreement, it held that ANSAC was prima facie a cartel which was carrying out part of its trade practices in India, giving the Commission jurisdiction under Section 14 of the MRTP Act, even though the cartel itself was formed outside India. The Commission also noted that the 1990 orders of its EC counterpart, holding that the ANSAC agreement was restrictive of competition, "have a persuasive effect in the instant case" (p. 307). ANSAC's pleading of the gateways under Sections 38(b) and (h) could be considered at the appropriate stage of enquiry, but the Commission did record the kind of efficiencies that ANSAC was claiming:

> *Among the reasons why export sales by ANSAC are more advantageous than export sales by individual members are: (a) access to larger supplies of soda ash, (b) ability to offer uninterrupted supply to overseas customers, (c) ability to pool*

[18] *Alkali Manufacturers' Association of India vs American Natural Soda Ash Corporation (ANSAC) and others,* 1997(5) CTJ 288 (MRTPC).

> *risks, (d) the flexibility of a single dedicated export staff with expertise in the area of exports, (e) the capacity of minimizing distribution costs and (f) improved access to Government assistance, where available. (p.300, para 44)*

The Commission confirmed its earlier injunction, on the grounds that ANSAC was prima facie a cartel. It clarified, however, that the American firms could export to India individually, dismissing ANSAC's contention that they were unable to do so without the efficiencies provided by the joint marketing arrangement. Here the Commission referred (in para 74) to the EC Commission's observations on their ability to compete amongst themselves and with the European producers. It went on to assert that the claimed efficiencies were not necessary for supplying the Indian market, but only afforded the American producers a greater advantage than they could obtain individually. This ignored a crucial difference between the Indian situation and the European one, which the Commission had noted while summarising ANSAC's defence: the American firms had not previously supplied the Indian market (para 34).

In its interim order in March 2000, the MRTPC went over much the same ground, reiterating that ANSAC was *prima facie* a cartel, notwithstanding it had a legal identity distinct from that of its members. ANSAC then appealed to the Indian Supreme Court, which in a far-reaching verdict delivered in July 2002, overturned the MRTPC orders. It did not go into the allegation of cartelization, but instead held that the wording of the MRTP Act did not give it any extra-territorial operation. The Commission could therefore not take action against foreign cartels or the pricing of exports to India, nor could it restrict imports. Action could be taken only if an anti-competitive agreement involving an Indian party could be proved, and that too only after the goods had been imported into India.[19] The only remedy available to the domestic manufacturers was an anti-dumping duty. The Court observed in passing that prima facie, ANSAC's

[19] *Haridas Exports vs All India Float Glass Manufacturers' Association*, (2002) 6 SCC 600. The two parties named in this case were involved in another dispute involving similar issues; the ANSAC appeal was joined with it for hearing and judgment. I discuss the wider implications of this judgment, and Indian competition policy in relation to international trade, in greater detail in Bhattacharjea (2003a and 2003b).

contention that it was the Indian producers who had formed a cartel did "merit consideration, perhaps in another case".

Although a Supreme Court ruling would normally have closed the matter, the story did not end there. The verdict was announced while a new Competition Bill was pending in the Indian Parliament. In December 2002 when it was being passed, the government moved an amendment inserting a new sub-section 33(2) that would allow the Competition Commission (the designated successor of the MRTP Commission) to grant a temporary injunction restraining any party from importing goods, if it could be established that such imports would contravene the Act's substantive provisions. However, another amendment was also passed, exempting efficiency-enhancing joint ventures from the Act's prohibition of hard core cartels. The new Competition Act is yet to take effect at the time of writing, because the Indian government has announced that the first year of its operation would be used for competition advocacy and education, with its cartel provisions coming into effect only in the second year. It remains to be seen, therefore, whether the domestic industry will again try to obtain an injunction against imports from ANSAC under the new Act, whether ANSAC (which described itself as a joint venture in the South African case to be discussed next) will employ the efficiency defence, and whether the new Commission will accept it.

C. South Africa[20]

Botswana is second only to the United States as a producer of natural soda ash, most of which is exported, with neighbouring South Africa being a major buyer. In October 1999, Botswana Ash (Pty) Ltd. (Botash) filed an application for interim relief with the South African Competition Commission, alleging that ANSAC was infringing the sections of the Competition Act that prohibited agreements involving price-fixing and market sharing. The Commission, after conducting an investigation and finding that a prohibited practice had been established, referred the matter to the Competition Tribunal. In the ensuing interlocutory proceedings, apart from raising procedural and jurisdictional

[20] The following account is based on the judgments of the South African Competition Tribunal, decidedcases/doc/49CRAPR00-1.doc and 49CRAPR00-2.doc and Competition Appeals Court, Case12/CAC/Dec01, all downloaded from www.comptrib.co.za on 6 June 2003.

objections, ANSAC argued that even if price fixing or market sharing could be established, a 'purposive' reading of the relevant sections of the Act (i.e. taking legislative intent into account) would allow it to put up a defence that its agreement resulted in an efficiency or pro-competitive benefit that outweighed its negative effects. In March 2001, the Tribunal overruled all these arguments. On the admissibility of the efficiency defence, which is what concerns us here, it held that legislative purpose would be relevant only if the statute were ambiguous. But Section 4(1)(b) of the Competition Act explicitly condemned price fixing and market sharing as illegal *per se*, as distinct from 4(1)(a) which allowed an efficiency defence for horizontal agreements that adversely impacted competition. Neither a textual analysis, nor a purposive reading, nor considerations of public policy or international comity, admitted of any other interpretation.

Later the same year, ANSAC tried to introduce the beneficial effects of its agreement before the Tribunal in a more roundabout manner. It contended that it needed to establish these effects in order to dispute the Tribunal's jurisdiction, because the 'effects' doctrine contained in Section 3(1) pertained only to *deleterious* effects on competition. This too was dismissed by the Tribunal, again on the basis of a plain reading of the Act. ANSAC's appeal on both these issues (the admissibility of the efficiency defence, and the effects test being applicable only to negative effects), along with other procedural objections, was subsequently dismissed by the Competition Appeals Court. Noting various provisions of the ANSAC membership agreement, the Court dryly observed "It is therefore no surprise that Ansac's activities attracted the attention of the European authorities" (para 26). It upheld the Tribunal's decision that the clear wording of Section 4(1)(b) made price fixing illegal per se, without the possible extenuating circumstances allowed in EU law. Nonetheless, it did record the nature of the efficiencies that ANSAC was trying to argue, which are worth quoting in order to lay the foundation for the theoretical discussion in the next section:

> *[T]he appellants seek to place evidence before the Tribunal to show that Ansac is a legitimate joint venture whose purpose it is*

to pool costs and resources so as to make it possible for them to trade competitively within exports markets where there are barriers to entry and significant risks. They seek to demonstrate that by virtue of pooling costs and resources Ansac has been able to appoint independent sales and distribution staff dedicated solely to sales and services of customers, has been able to negotiate and obtain decreased freight and stevedoring charges and has entered into a variety of cost-reducing overseas warehousing and distribution agreements. The result of this is that Ansac has achieved reductions in marketing and distribution costs and can undertake competitive sales to new countries and overseas markets including those with high logistical and political risks and offer customers worldwide the enhanced reliability and efficiency made possible by increased volumes and the back-up supply commitments of US soda ash producers. (Para 27)

D. Venezuela[21]

In the earlier three cases, ANSAC tried unsuccessfully to convince the relevant competition authorities that it was not a cartel but a trading company or joint venture. In Venezuela, its problems took a different turn. In 1998, a Venezuelan distributor named Proquim alleged that the cartel, behaving like a monopolist, was charging a much higher price from Proquim than from its own distributor, and also imposing a clause in its contracts with its customers that required them to notify ANSAC if they received a better offer from other suppliers. This 'evergreen' or 'English' clause, and refusal to deal, are regarded in Venezuela and some other jurisdictions as an abuse of market dominance, because they can serve as an exclusionary practice designed to keep out rivals. (Similar clauses had formed part of the EC Commission's decisions against ICI and Solvay, in the twin cases referred to in n.16 above). Procompetencia, the Venezuelan competition agency, decided against ANSAC, ordering it to stop the malpractice and sell to Proquim, an order with which

[21] Because the documents of the competition agency were available on the Internet only in Spanish, I have relied on a case study entitled "International Business Ethics" prepared for the Katz School of Business, University of Pittsburgh, posted at : www.pitt.edu/~ethics/Venezuela/firm.html, downloaded on 23 June, 2003.

ANSAC complied. In this case, it was the complainants who apparently claimed that ANSAC could obtain economies of scale in shipping costs, which gave it a dominant position.

E. Comparative Assessment

Looking back at the four cases, notice the diversity in the motives of the initiating parties. In the EEC, it was ANSAC itself that sought an exemption (although its European rivals might well have brought a complaint if it had not); in India an injunction was sought by an association of the domestic manufacturers who were threatened by competition from ANSAC; in South Africa the complainant was the incumbent dominant supplier belonging to a neighbouring country; and in Venezuela the case was filed by a trading company that sought to sell ANSAC's product. In every case, the putative efficiencies of a joint marketing arrangement were raised, but again with different motives: in the first three jurisdictions, they arose out of ANSAC's attempt to claim an efficiency defence for a practice that restricted competition (and additionally to escape anti-dumping duties in the EEC), while in Venezuela the efficiency argument was used *against* ANSAC to establish that it had a dominant position. The relevance of these efficiencies in deciding the cases also differed between jurisdictions. In the EEC, they were considered and rejected; in India and South Africa they were noted but not considered, as the per se illegality of a cartel was enough to indict ANSAC (and the competition law's lack of extra-territorial jurisdiction was enough to save it on appeal in India). Only in Venezuela did the efficiencies seem to carry some weight, although the case was ultimately decided on the issue of exclusionary contracts.

The efficiencies that ANSAC claimed were also slightly different in each jurisdiction. But a consolidated list provides a fairly comprehensive idea of the kind of advantages such cartels might have, and extends the present discussion to export cartels in general. Using the analytical categories familiar to economics, we get the following taxonomy.

1. *Saving on variable costs* of transportation, warehousing and handling, by being able to negotiate better rates for larger volumes.

2. *Saving on the fixed costs* of market research and setting up and maintaining networks and facilities for shipping, customs clearance, storage, marketing and distribution, and liaison with government officials where necessary. These are likely to be specific to each destination, and individual producers might find that their volumes are too small to justify incurring such costs. Or they could avoid unnecessary duplication by centralizing these functions in a common agency.
3. *Pooling of risks:* although not spelt out in any of the case reports, this appears to involve two separate considerations. First, access to the production facilities of many producers yields a more reliable source of supply, resulting in the cartel being better placed to meet orders. Second, common marketing gives each producer a share in a diversified portfolio of buyers, spreading the risks of non-payment by buyers, demand slumps, or disruption in deliveries caused by political or natural events in particular markets.

This list overlaps substantially with that of the OETCA's promotional literature. Clearly, advantages under 1 and 3 can only be obtained through the setting up of a CSA, and not through the looser kind of cartels that figure in economic theory.

5. Economic Analysis

Firms, of course, have an incentive to eliminate competition even if there are no real efficiencies to be had. So do their governments, as we saw from the brief review of the relevant theory in section 2, provided there is no adverse impact on the domestic market. The following questions are then relevant from the perspective of policymakers in the importing countries: Are these real efficiencies, or are they just a convenient excuse to avoid the strictures of the competition authorities? Second, if they are real, are they available to firms that do not join the cartel or defect from it? Third, should they be taken into account by the competition agencies of the importing countries, tempering their condemnation of hard core cartels? And finally, if the verdict nonetheless goes against the cartel, what would be the appropriate remedy?

A. Efficiencies

It might seem that the answer to the very first question, and thus the subsequent ones, requires familiarity with the conditions of each industry, but economic theory provides a fairly simple and robust answer. In its anti-competitive aspect, a cartel (and certainly one that takes the form of a joint venture or CSA) is isomorphic to a horizontal merger. And it is well known that in order to be profitable, such a merger must involve *either* a large proportion of the suppliers (and barriers to the entry of new ones), *or* significant cost reductions. This is because output restriction by the merging firms provides free rider benefits in the form of raising a “price umbrella” for non-participants, and their increase in output can undermine the profitability of the merger. A cartel of the producers in a single country, unless it dominates the world market, is unlikely to fulfil the first condition. Therefore if such an arrangement is observed, it must result in cost reductions. Its impact on competition is therefore ambiguous, with its sales restricting effect pulling against the cost reduction effect.

Linking the question of efficiencies to the cartel’s market share was suggested by antitrust scholar and judge Robert Bork (1966) in the context of American antitrust laws. Bork argued that a horizontal market division or price-fixing agreement should be treated as lawful if it could be shown to be “ancillary” to a “contract integration” between the firms, whose primary purpose was something other than output restriction. It had to be demonstrated that the agreement was no broader than necessary to achieve that purpose, and that the producers’ combined market shares made output restriction unlikely. The EU’s exemption criteria under Article 81(3) are informed by a similar logic. While the U.S. generally implements the Sherman Act as a *per se* prohibition of cartels other than export cartels, there are exceptional cases in which its Supreme Court has considered a so-called “benign cartel” defence under a Rule of Reason, involving efficiency arguments (Posner 2002, pp. 29-32). An export cartel commanding a small share of the world market, and limiting its activities to marketing, could enter a defence of this kind in the importing jurisdiction.

One possibly important case, relevant to developing country imports, in which this reasoning may not hold is when the exporting country has a low share of the world market, but a high share of a particular country's market. There is considerable evidence that many small developing countries trade disproportionately with the European countries that once colonized them, even decades after achieving formal independence (Rauch 1999). There seem to be informational, cultural and institutional barriers to entry by suppliers from other countries; or possibly the fixed costs of establishing the necessary marketing and distribution networks are large relative to market size. In such cases, an agreement by European firms to fix prices or rig bids would be purely anti-competitive, because these barriers would prevent free riding by suppliers from other countries. True, export associations are not geared to particular national markets; it is more likely that collusion takes place on a case-by-case basis taking advantage of the implicit exclusion for exports in EU competition law. Of course, more research is needed to support this admittedly speculative hypothesis.

Further on the subject of free riding, and in answer to the second question raised above, the nature of an export cartel is such that there are powerful incentives for other producers of the same product within the same country to join such an arrangement. Precisely because a single-country export cartel is unlikely to be able to raise the price significantly in foreign markets (and might in fact depress it, if the efficiency benefits are significant) there is much less scope for non-participants benefiting from the participants' price umbrella. Nor, because of the nature of the efficiency benefits, can the non-participants hope to free ride on them. (Contrast the possible benefits listed at the end of the preceding section with joint research and development, whose benefits can spill over to non-participants.) Production costs of those who do not join, on the other hand, are likely to be similar to those of the members, since they belong to the same country. This will put non-members at a competitive disadvantage in respect of exports. The benefits of the cartel will therefore induce non-participants to join in, or be displaced from export markets. And once they become members, the same arguments dissuade them from defecting, which is the bane of orthodox cartels. At the same time,

the efficiency benefits listed above (except perhaps Type 3) are by their very nature specific to each exporting country, and cannot be obtained by other nations' suppliers, even if they could join in. Thus, such an arrangement is likely to be confined to each exporting country.

To sum up the foregoing analysis, from the point of view of non-members, whether belonging to the same country or other countries, export cartels yield limited free rider benefits on the revenue side, and no such positive externalities on the cost side. By enhancing the competitiveness of members, the efficiency benefits may in fact result in negative pecuniary externalities being inflicted on non-members. The cost benefits are specific to exports and arise only within and not across countries. In some or all these respects, export cartels are different from other types of inter-firm collaboration, such as joint advertising, lobbying, training or research activities, or true international cartels that include producers from many countries. The incentive structure of export cartels thus makes them a distinct economic category, independent of their membership rules as well as the legal regime in force in their country of residence.

The third question, relating to the importing country's assessment of an export cartel, is not as easy to answer. We measure social welfare in the usual way as the sum of consumer surplus, producer surplus (that is, profits in excess of the normal return to capital), and tariff revenue accruing to the government. There is of course a vast literature on the efficiency defence of a domestic merger, following from Williamson (1968), exploring the trade-off between increased profits and reduced consumer surplus. Applying this analysis to export cartels requires two substantial modifications. First, the nature of efficiencies is different, and a cartel, even if it takes the form of a CSA, cannot secure all the cost savings that would accrue from a merger. For example, it cannot reallocate human and physical capital optimally across production units, and it will incur transactions costs in dealing with them, which could have been avoided had they merged. Second, when the cartel is foreign-owned, its profits are irrelevant. Instead, we need to evaluate the effect of foreign cartelization on *domestic* consumers, producers and tariff revenues. The analysis can be conducted in two steps: first we determine the likely effect

on exports, taking into account the nature of efficiencies, and then the impact of this change on the different components of social welfare in the importing country.

The result of the first step hinges on whether the sales-restricting effect of the cartel outweighs its cost-reducing effects, that is, whether it promotes or retards exports as compared to a situation in which the members operated independently. Clearly, at least the Indian and Botswanian complainants saw ANSAC as a competitive threat, and hence believed that it was on the whole export promoting. But the European Commission seems to have regarded ANSAC as anti-competitive, unless it divorced its marketing functions from its pricing and market-sharing policies. Again, some elementary insights from theory are helpful in determining the net effect of cartelization on exports. Here we need to distinguish between foreign cartels that are new entrants into the market, and those whose members have earlier operated there in their individual capacities. Taking the case of new entry first, the very fact that the foreign firms were not supplying the market earlier makes it likely that the efficiencies claimed by the cartel are what enables them to do so, and thus an injunction to force them to compete individually is as good as an import prohibition. The choice then is between some new entry and none.

If the foreign firms were already active in the domestic market prior to cartelization, the situation is more complicated. Referring to the taxonomy at the end of Section 4 above, if the efficiency gains were of types 2 or 3, they would benefit the firms but would not have any effect on the outcome in an export market where they (the firms) were already present. Here only the anti-competitive effect of cartelization would be relevant, and an injunction requiring them to resume exporting individually is feasible for the firms, in light of their previously demonstrated ability to do so. If, on the other hand, cartelization reduces the per unit costs of supplying the export market (Type 1 above), then regardless of market structure, standard theory would lead us to expect a positive impact on the level of exports, pulling against the sales-restraining effect of cartelization. The literature on cost-reducing horizontal mergers is again suggestive. Assuming Cournot behaviour by the merged entity and its remaining competitors, Farrell and Shapiro (1990) show that output cannot rise

if the merger only allows for reallocation of production across the formerly independent firms with differing cost levels. In the present context, this would be analogous to a CSA sourcing its supplies from different members so as to minimize costs.[22] They also show that output will fall unless cost reductions on account of economies of scale or synergies between the merging firms are substantial. Even with such efficiencies, a decline in output is more likely, the larger the market share of the merging firms, the smaller the industry elasticity of demand, and if merger makes industry conduct more collusive (which was the European Commission's concern in its treatment of ANSAC).

B. Effects on Importing Countries

Turning to the effect of changes in exports on welfare in the importing country, market structure is important. The evidence on cartels suggests that they are found mainly in oligopolistic industries producing homogeneous products, which makes it more than likely that the import-competing industry (if one exists) is also oligopolistic, especially in developing countries.[23] If there is no domestic production, there is no producer surplus, and we get an unambiguous answer: if the cartel decreases exports, it reduces welfare in the importing country by hurting consumers. If there are oligopolistic domestic producers, however, they will benefit from the "price umbrella" of the foreign cartel, at the expense of domestic consumers, and we have a trade-off.

After obtaining the likely direction of change in the output of the merging firms ('insiders'), Farrell and Shapiro then treat it as exogenous and derive its effect on consumer surplus plus the profits of 'outsiders' (non-merging firms). Although their paper was concerned with welfare effects within the merging firms' home country, their approach is useful in the present context. This is because if all producers of a good in a country form an export cartel (which I argued is likely), and it has no effect on home consumers (which is essential to gain exemption from the home competition authorities), then this external welfare effect falls entirely on the importing countries. It turns out that a small reduction in 'insider' output has a positive external effect if and only if the

[22] Spector (2003) has recently shown that this result holds irrespective of entry conditions.

[23] The empirical studies surveyed in Lee (1992) show that industrial structures are much more concentrated in developing as compared to developed countries, controlling for industry-specific effects.

weighted sum of the outsiders' market shares exceeds the insiders' market share, where the weights are a parameter that captures firms' response to exogenous output changes, and is a function of demand and cost conditions. A negative external effect is more likely, the larger the insiders' market share relative to that of the outsiders, and the smaller the latter's output response.

We are, however, more interested in welfare effects in a single importing country. In Bhattacharjea (2002a), building on several earlier contributions to the oligopoly trade literature, I demonstrated that for free trade and a given number of domestic firms, social welfare exhibits a J-shaped relationship in the number of foreign firms, first dropping below the autarky level for limited foreign entry, and then rising above it for more substantial foreign penetration. Foreign penetration can also be reinterpreted in terms of the total volume of imports, or their market share, as long as the domestic firms treat foreign supply as exogenous. It does not matter whether changes in foreign supply emanate from one exporting country or several.

The J-curve is derived under free trade, but the 1980s theoretical literature on "strategic trade policy" showed that if foreign supply is imperfectly competitive (which it must be, if we are dealing with cartels), some tariff is optimal in maximizing welfare, but is almost impossible to calculate empirically. What we do know is that it is likely to be moderate in magnitude: typically in the low double-digits in percentage terms, but higher if the prices of inputs used by the import-competing industry are above their social cost on account of market imperfections (Levy and Nolan, 1992). Further, for linear demand and constant costs, the optimal tariff is inversely related to the number of foreign firms. And it can be shown that if the tariff is adjusted optimally, the J-curve disappears, and welfare increases monotonically with foreign entry (Bhattacharjea 2002a). Adapting this result to the present context, welfare will decline if the foreign cartel restricts its sales and the home government adjusts the tariff rate appropriately.

C. Remedies

The policy implications of the theoretical results discussed above obviously depend on the specific circumstances. If there is no domestic production,

evaluation of the cartel is relatively simple, as welfare varies directly with foreign supply. A cartel whose net effect is to restrict sales is unambiguously bad. With domestic oligopoly, under free trade, if the foreign cartel is a new entrant, is the major source of imports, and takes only a small share of the domestic market, then welfare will decline when it enters. As long as we remain on the left-hand branch of the J-curve, welfare will decline even more if the cartel members are forced to compete individually and therefore increase their sales. As I argued above, however, they would probably withdraw altogether from the domestic market, if the efficiencies of joint marketing were what allowed them to enter in the first place. Such withdrawal, or otherwise a prohibition of imports, would actually enhance the importing country's welfare.[24]

If the firms constituting the cartel were already present in the market, an injunction to disband the cartel would presumably not compel them to withdraw, as they were already competitive even without the efficiencies provided by collusion. In this case the welfare effect of restoring the non-collusive outcome would be ambiguous, depending on which branch of the J-curve we are on. On the left branch where cartelization would have raised welfare, an injunction would reduce it again, and import prohibition would actually increase it further. On the other hand, if imports already had a large share of the domestic market, then we are more likely to be on the right-hand branch of the J-curve, where welfare varies directly with foreign supply. If the foreign cartel restricts its sales, home welfare decreases, and an import prohibition decreases it further. In this case an injunction to disband the cartel will restore the original welfare level, as presumably the firms can supply the market individually as they were doing earlier. Departing from free trade, the same is true if the tariff is close to the optimal level (moderately high for limited import penetration, or low for substantial penetration). No policy implications can be inferred for the combination of high tariffs and substantial foreign penetration, but that

[24] Other foreign suppliers who were not members of the cartel would of course take the opportunity to expand their exports, but unless 'conjectural variations' are exactly minus unity, this would not fully compensate for the cartel being shut out – and it can be shown that a conjectural variation of this magnitude would have resulted in a perfectly competitive outcome in the first place. Bhattacharjea (2002a) shows how output is affected by changes in the number of foreign firms under Cournot competition.

particular combination is unlikely to be observed. Even for the other cases, the crucial level of imports at which the J-curve reaches its trough, as well as the optimal tariff, depend quite sensitively on market structure, cost and demand parameters, and will be almost impossible to calculate in practice. These results should be taken only as a rough guide to the likely welfare effects of cartelization for very large and very small levels of import penetration.

An injunction against the cartel, if carried out, at best restores the pre-cartel outcome, and neither compensates for the damage that was done, nor deters collusion in the future. A heavy fine contributes to both objectives, and also adds teeth to the injunction. But it is difficult to see how a fine can be enforced if the firms have no assets in the fine-imposing jurisdiction. The *threat* of an import prohibition might be used to induce the indicted firms to assist with the investigation, and to abide by the injunction and pay the fine in the event of an adverse judgment. Game theorists would argue that if the import prohibition worsens domestic welfare, the threat is not credible. But the protectionist tendencies of most government agencies, as amply illustrated in the ANSAC cases, would give them a certain "reputation for irrationality" that would provide the necessary credibility. There is, however, the further problem in small developing countries that the cartel members will weigh the penalty, which is usually some multiple of the excess profits earned while the cartel was in force, against the non-collusive profits they can earn in future. They may well choose to abandon the market altogether rather than pay the fine, yielding the same result as an import prohibition, which we saw is welfare-improving only in certain cases. The fine must therefore be suitably moderated, inevitably weakening its deterrent effect.

An alternative measure, which could be combined with a moderate fine, would be to impose (or raise) an import duty. The strategic trade policy literature showed that the optimal tariff is inversely related to the number of foreign firms (Brander and Spencer 1984; Bhattacharjea 2002a), the level of their marginal costs, and the competitiveness of their conduct, as measured by a conjectural variations parameter (Dixit 1988). A reduction in any of these can be said to capture an aspect of foreign cartelization, and therefore to justify a higher tariff. Moreover, an optimal tariff does not shut out all imports. Two

interesting papers have shown, in models with no consumption in the exporting country and no production (and linear demand) in the importing country, that a threat of resorting to such a tariff by the latter might even induce the former to crack down on its export cartels. In game-theoretic terms, the optimality of the tariff makes the threat *credible*: it is in the government's interest to carry it out. Cowan (1989) showed in a sequential-moves game that a country deciding the number of its exporting firms before (and in anticipation of) the importing country's optimal tariff response would be better off with a perfectly-competitive export industry because it would induce free trade on the part of the latter. More recently, Hoekman and Saggi (2003) show that an agreement in which the exporting (developed) country prevents cartelization of its industry in exchange for the importing (developing) country adhering to free trade can be supported as the equilibrium of a repeated game with simultaneous moves. If both governments do not weigh the immediate gains from violating the agreement too much more than the future benefits of adhering to it, the agreement is self-enforcing, sustained by credible threats of reverting to non-cooperative behaviour (non-enforcement of its cartel prohibition by the developed country; imposition of an optimal tariff by the developing country).

There are several problems with these attractive options, however. First, the strategic trade literature showed that the tariff formula is extremely sensitive to the underlying parameters of the model. In fact, Cowan (1989) showed that with iso-elastic instead of linear demand, the importing country's optimal tariff on a foreign monopolist is negative, i.e. an import subsidy. Far from deterring cartelization, this would encourage it ! Also, as the more recent models of strategic trade policy under asymmetric information have shown, domestic and foreign firms who are better informed about these crucial parameters than the government have an incentive to mislead the latter, resulting in welfare-reducing policies (see the literature cited in Bhattacharjea 2002b). There is also a problem of fairness: even if the optimal tariff is positive and raises domestic welfare, it does adversely affect domestic consumers, adding insult to the injury they have suffered from the cartel. Ideally, the tariff revenues (and those from the fine) should be transferred to them, but identifying those who have been harmed will be virtually impossible. And

finally, there remains the original problem of detecting the foreign cartel (or proving non-enforcement of the cartel prohibition by its government). In the concluding section, I suggest a way in which to deal with this vexatious issue.

6. Conclusions

It is disappointing that no unique policy prescription emerges from our analysis; as usual when we allow for oligopolistic market structures, "it all depends". What this paper has done is to offer a starting point, indicating the various facts that need to be considered in determining whether a foreign export cartel is beneficial or harmful to the importing country. Among them are: whether the cartel is a new entrant; the nature of the efficiencies it claims; the market structure, demand elasticity, degree of import penetration, and prevailing level of tariffs in the importing country. Clearly, neither a per se prohibition nor a passive acceptance of efficiency arguments is appropriate, and hence an international agreement that takes either of these two extreme positions is inadvisable. We are led inescapably to treatment under a rule of reason for each individual case, and a qualified argument for imposing fines and raising import duties on offending firms.

The problem, of course, is that competition agencies in most countries would not have the expertise to undertake such reasoning, nor the extra-territorial reach required for discovery of evidence and enforcement of penalties. The proponents of a competition policy agreement at the WTO were never willing to offer anything more than technical assistance and limited voluntary cooperation, and are likely to be even less forthcoming now that their efforts have been thwarted. Absent an international enforcement authority, or developed countries' willingness to start prosecuting their own export cartels (as suggested by Hoekman and Mavroidis 2003 and Singh 2003), there is little that developing countries can hope to gain on this front by simply enacting competition laws, as suggested by the proponents.

In this context, I would like to suggest a novel approach, based on parallels with anti-dumping (AD) procedures, that could lighten the evidentiary burden of prosecuting both multi-country international cartels and single-country export cartels. The Uruguay Round AD agreement allows much

greater latitude for countries to address dumping than do standard competition law approaches to discriminatory or predatory pricing. In recent debates on the interaction between trade and competition policy, many scholars argued that application of antitrust standards would help to curb the abuse of AD procedures – but developed countries consistently refused to accept this suggestion.[25] The relaxed standards of AD could, with much greater justification, be applied to foreign cartels whose overcharging is after all the mirror image of dumping. (Indeed, it is sometimes referred to as “reverse dumping”). For example, instead of requiring proof of a price-fixing conspiracy, the enforcement agency could be required to demonstrate that the price exceeds some “normal value”. [26] As with AD, this could be assessed on the basis of best information available regarding the firms’ costs, or the prices they charge in their own or other markets.[27] Other leaves that could be taken from the AD book include norms for defining a “like product” (to avoid penalising firms which sell different varieties in different countries); retroactive assessment; and provisional measures such as requiring bonds or advance deposits from respondent firms while the case is pending. With the qualifications expressed at the end of the preceding section, the penalty could include both a fine and an “anti-reverse-dumping” duty. Like an AD duty, this would be discriminatory and firm-specific, and possibly in excess of the country’s bound tariff rate. This would be justifiable on welfare grounds, unlike most AD duties, which are blatantly abused.

Obviously, some provisions of the AD agreement would not be applicable, such as the standing given to domestic producers as complainants, or the requirement that they prove that they have been injured by the dumped imports. Although reverse dumping places domestic consumers in a symmetric position, they cannot be expected to initiate action or shoulder the burden of

[25] See Hoekman and Mavroidis (2003, p.15) and Bhattacharjea (2003a, pp.219-20) and the references cited there for details.
[26] Even for domestic antitrust enforcement, no less an authority than Posner (2001, ch. 3) has argued, with careful regard to practicability, for a move away from the traditional approach based on uncovering conspiracies towards one based on economic evidence of collusion, including price discrimination and regional price variations.
[27] Evenett (2003, p.96) has argued that international cartels charge lower prices in countries with active competition agencies. To the extent this is true, the price comparison suggested

proof. Instead, the inquiry could be triggered by an abnormal rise in import prices, registration of the cartel in its home country, or by investigations being carried out against the same firms in other jurisdictions. Evidence of this nature could even be deemed sufficient to create a rebuttable *presumption* of cartelization, reversing the burden of proof.

Like AD petitions, this procedure would not require the evidentiary standards (and hence cooperation from the respondents and their governments) of an antitrust case. Countries whose competition agencies are denied such cooperation could consider unilaterally applying these relaxed standards to foreign firms. Although the Dispute Settlement Panel in the 1997 *Kodak—Fuji* case held that national competition laws were subject to the core WTO principle of National Treatment, discrimination of this kind cannot be said to be trade-restricting, and would arguably not constitute an infringement of GATT obligations.[28] (This point might be worth settling in a test case that led to formal dispute settlement proceedings.) If the issue of a multilateral agreement on competition policy were to be revived, despite its apparent demise at Cancun, developing countries could press for one along the lines suggested above. This would give them a better chance of taking on foreign cartels than the agreement envisaged by the proponents, while laying down procedures, rules of evidence, and permissible penalties so as to safeguard the other WTO principles of transparency and procedural fairness, and prevent protectionist abuse.

A more audacious proposal, particularly appropriate for products like pharmaceuticals and speciality chemicals whose producers are notorious for their cartel activities, would be a WTO agreement on competition policy that would allow members to suspend the offending firms' rights under the TRIPS

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here would allow agencies in poor countries to free ride on the activities of their better equipped and experienced peers, without their explicit cooperation.

[28] Bhattacharjea (1998) adapted a standard regulatory mechanism to the problem of optimal policy towards a foreign monopolist (which could be a special case of a foreign export cartel) whose costs are unknown to the regulator, showing how the optimal mechanism could be implemented by making the monopolist choose from a menu consisting of a per-unit tariff or import subsidy and a fixed payment. The paper proved that such a mechanism maximizes expected consumer surplus (and is thus trade-promoting on average), and that the government's expected revenue is zero (so that, again on average, it is not "a taxation of imports or exports for fiscal purposes", which would violate Article VIII of the GATT). Although

agreement, perhaps by issuing compulsory licenses for any of their products protected by patent. After all, the GATT allows countries to retaliate against other *members* who are found to violate one agreement by suspending concessions under other agreements. Since the retaliation usually takes the form of increasing tariffs on a range of the violating country's exports, it is likely to inflict a welfare loss on the retaliating country itself, and also on exporters who had nothing to do with the violation. Cross-agreement retaliation, applied to the offending *firms* in a cartel case in the form of suspension of their patent rights, would not involve self-injury by the retaliating country, and be precisely targetted at the beneficiaries of the violative conduct. It would also be appropriate in light of the constraints on collecting monetary fines. More generally, the GATT/WTO framework, as it stands, confers valuable rights (market access, intellectual property protection) on firms, with no reciprocal obligations. Suspension of those rights would be an appropriate penalty for anti-competitive behaviour. If nothing else, the debate would hold up a mirror to the many flaws in the AD and TRIPS agreements.

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such a mechanism is too sophisticated for real-world trade policy, the so-called Revelation Principle ensures that it serves as a benchmark for the best that can be achieved.

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