Available online at www.sciencedirect.com
ScienceDirect
International Journal of Industrial Organization
24 (2006) 1079–1082
International Journal of Industrial Organization
www.elsevier.com/locate/econbase

The economics of cartels, cartel policy, and collusion: Introduction to the special issue

Keywords: Competition policy; Antitrust policy; Collusion; Tacit collusion

There was a time when collusion was thought to be an ephemeral phenomenon – often alleged, sometimes attempted, rarely enduring. The cartel registers of Europe should always have raised doubts about this view in the event that collusion was not prohibited (Brusse and Griffiths, 1998). Evidence from business history and contemporary antitrust enforcement efforts suggests that the legal prohibition of collusion (and the levels of fines anticipated from being caught in the act) may be enough to drive collusion underground, but not to eliminate it as an equilibrium choice for some firms in some industries, and this justifies the attention given to the subject in this special issue.

Economic writings on collusion are as old as the profession itself. At least two intriguing aspects of the act of colluding are responsible for this long-lasting interest. First, the possibility that subgroup pursuit of some joint interest can harm society is at odds with the cooperative foundations on which many societies are built. In this respect, joint profit maximization is no different from any other interest group protecting the interest of its members. What is intriguing is that an agreement between agents that is mutually beneficial – a concept that lies at the heart of the economics profession – can be detrimental to society as a whole. Second, with the legal prohibition of collusion came the understanding that the objectives of collusion can sometimes be attained without violating the law; agents just act to observe what would be the terms of a contract that specifies the details of a collusive agreement, without the existence of such an agreement.

The first of these puzzles initiated the early writings on the economics of collusion (starting with Adam Smith's famous quote) and triggered a large literature on appropriate policy measures to prevent firms from expressly colluding. In modern writings it is first and foremost empirical studies that address the positive aspects of collusion. These studies justify the implementation of current competition policies.

The second puzzle is responsible for an ever-expanding stream of models dealing with the economics of *tacit* collusion. These models suggest policy prescriptions, because understanding how firms tacitly collude naturally suggests the contours of an effective antitrust policy toward tacit collusion. This wide array of modelling options originates in the dynamics inherent to tacit collusion (Becker, 1968). The debate as to how to capture these dynamics is not likely to be settled anytime soon.

0167-7187/$ - see front matter
doi:10.1016/j.ijindorg.2006.04.006

The papers collected in this special issue can be traced back to one or the other of these two puzzles. They marshal empirical evidence and theoretical analysis about the mechanics and effects of collusion and the impact of anticollusion policy on market performance.

Nicolas de Roos offers a case study of collusion in the world lysine market that joins the growing number of case studies of the mechanics of real-world collusion.[1] Our models of collusion often abstract from the incomplete and imperfect information and bounded rationality that characterizes real world cartels (along with all other economic activity). de Roos discusses discrepancies between theoretical predictions and events in the lysine cartel. The discrepancies he identifies may best be understood as enabling cartel members to gain the levels of information and understanding that is presumed, in theoretical models, to obtain from the beginning.

A second empirical paper, by John M. Connor and Yuliya Bolotova, contains material relevant to recent debate whether or not antitrust is worth it, in terms of improving consumer welfare.[2] Their analysis of empirical estimates of cartel overcharges suggests that typical antitrust penalties for collusion may be insufficient for deterrence purposes, particularly as regards durable international cartels. Their work also suggests that a tougher antitrust treatment of collusion reduces cartel overcharges.

Two papers deal with the sustainability of tacit collusion. The first, by Maria Arbatskaya, Morten Hviid, and Greg Shaffer, tests empirically whether low-price guarantees facilitate tacit collusion. Using a sample of retail tire prices, they find that firms that have price-matching guarantees tend to have weakly higher prices on identical items than firms that do not have low-price guarantees, whereas firms that have price-beating guarantees tend to have lower prices. Thus they conclude that price-matching guarantees are consistent with facilitating tacit collusion while price-beating guarantees are not. Charles J. Thomas and Robert D. Willig model the impact of multimarket contact on noncooperative collusion. They note that although defection in any part of a collusive scheme that extends over many markets may be more readily detected because of the scheme's multimarket character, punishment will extend over many markets as well. If (as will be the case in equilibrium) punishment is triggered by exogenous shocks rather than actual defection, multimarket activity can result in greater forgone profits than market-by-market tacit collusion.

The remaining papers in the special issue explore the impact of antitrust or competition policy on cartel stability and on market performance. The first of these, by Joseph E. Harrington and Joe Chen, presents simulations of cartel behavior when anomalous price patterns may raise buyer suspicions and cause buyers to notify antitrust authorities. Their results – not without implications for the old administered pricing literature – suggest that a cartel may moderate price changes (say, in response to cost shocks) to avoid triggering consumer discontent.

In varying ways, Jeroen Hinloopen and Sylvestre Frezal consider the efficiency of anticartel policy. Hinloopen investigates the impact of anticollusion policy on cartel stability if the per-period probability of detection varies over time. If detection by the competition authority means that collusion stops, even modest odds of detection reduce the number of firms for which tacit collusion will be a noncooperative equilibrium. Also, a higher probability of detection at any point in the future makes the condition for internal cartel stability more stringent. As introduction of a small but positive detection probability has much more effect on internal cartel stability than an incremental increase in an existing probability of detection, the policy implication of

[1] Others are Ulen (1978), Genesove and Mullin (1999, 2001); for a survey, see Levenstein and Suslow (2001).
[2] For contrasting views, see Crandall and Winston (2003), Baker (2003).