Case study hard core cartel

Education

CASE STUDY: HARD CORE CARTELS Cartel refers to a group of firms producing substitute goods that collude or conspire to increase prices and its own profits, by lowering production and/or sharing markets or customers. Figure 1 below shows examples of recent price fixing cases from various countries. (Figure 1) These industries either have a market structure in which a small number of inter-dependent firms dominating the industry, that of a oligopoly, or are firms that is the only seller of a good or service that does not have a close substitute, characteristics of a monopoly.

Oligopoly and/or monopoly arise for four main reasons: government restriction to the entry of more than one firm into a market, an individual firm commands control over a key resource essential to produce a good, there are externalities in supplying the good and economies of scale are so large that one firm has a natural monopoly. A monopoly and/or oligopoly can produce lesser of the goods and charge at a higher price as compared to a competitive market industry producing the same good, due to the need to stay competitive. This usually leads to lower costs, lower prices, and consumer demanded goods.

However, due a market structure like that these industries, price conditions are such that competition is likely to lead to higher prices. Furthermore, governments intervene by regulating these industries and externalities, provide public goods, control the use of common resources and reduce income inequality. It is uncommon for monopolies to be fined with the exception, such as Microsoft, for illegal monopolistic practices. However, fines for companies operating in oligopoly markets that abuse market power through collusive agreements are more common.

Traditionally, the power cable industries in the European Union have been state-owned monopolies. During the 1990s, countries such as Germany, Sweden and the United Kingdom, privatized these industries and imposed price regulation to restrict market power. Power cable industries in Germany are highly competitive market and over the past decades, dramatic changes are observed in the way the government regulated the European economies. Cartel members engaged in market sharing, price setting, bid rigging, coordinated predation and delaying of innovation.

Hard core cartels can reduce the economic welfare and consumers' surplus because of the manipulation of market prices and/or quantity of goods. Consumer surplus is the difference between the highest price a consumer is willing to pay for a good and the price the consumer actually pays. (Figure 2) Depicted by Figure 2, consumer surplus is measured by the area below demand curve and above the market price, P1. Therefore, the higher the market price, the smaller the consumer surplus. By increasing price and reducing the quantity produced, the monopolist reduces economic surplus.

This reduction in economic surplus is called deadweight loss, which is a result from a market not being in competitive equilibrium. As indicated in the earlier section, cartels arise in market structures characterized by a small number of inter-dependent firms competing against each other. Factoring in this inter-dependence, the firms can enter a collusive agreement to manipulate market prices in a bid to achieve monopoly prices. While this may be the case, high prices may also be an incentive for the cartelists to breach the agreement by undercutting their rival firms and/or increasing production output, to attract consumers.

Cartels can have significant adverse effects on global economy. As with the case of Spain's domestic sugar cartel, the firms had detailed price-fixing and collusive agreements (e. g. import and export) that restricted the supply of sugar, in order to achieve maximum monopoly profits. As a result, for many years, Spanish sugar prices were 5 to 9 per cent higher than the rest of Europe. This illustrates how cartels can manipulate market prices and exploit the buyers of their products. Since sugar is considered a basic staple, this indirectly constitutes to greater economic loss.