The Incidence of Fines on Cartel Dynamic Pricing *

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Abstract

With Regulation 1/2003 the European Commission D-G for Competition has introduced administrative fines on corporation turnover to punish any breach of article 81 and 82 of the Treaty. To confine obvious adverse effects of a too harsh punishment fines have been limited to a thirty per cent cap of the undertaking’s worldwide turnover (Guidelines 2006/C 210/02). However, the assessment of the gravity is made on a case-by-case basis for all types of infringement. As a general rule, fines are calculated as a proportion of the value of sales. In this paper we study the distortion in pricing that stems from the application of fines on turnover in an environment where cartels choose their optimal pricing under uncertainty and business cycles. Our model shows how in a dynamic setting fines may resemble the effect of an ad-valorem taxation. The effect of fines on prices varies depending on the position on the cycle (expected demand growing or falling). We test our model using 328 weekly data on the Joint Executive Committee (JEC) and the econometric methodology suggested by Borenstein and Shepard (1996). While JEC was a legal cartel, in a counterfactual exercise we simulate the effect of the cartel being detected and fined on turnover. Our preliminary results cast a shadow over the recognized deterrence efficacy of the administrative fine system.

Keywords: C18, C73, K21.  
JEL classifiers: Cartel, Fine, Business Cycles

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