

Defending Energy Market from Monopolies & Cartels: The Antitrust Perspective

Paper submitted to CCCWS Journal

By

Ariella Berger

Head of Oil Alternatives and Energy Research,
The Israeli Institute for Economic Planning
Author

Dror Strum

President, The Israeli Institute for Economic
Planning, Former Director General of Israel
Antitrust Authority
Antitrust Review Editor

Introduction

The aim of this paper is to provide major insights about the way Antitrust related considerations may aide the prosperous and peaceful rise of both China and Israel.

Antitrust Laws are the main course of governmental intervention in "Free Markets". Western capitalism promotes the Free Market economy in order to produce the greatest wealth. Antitrust (Competition Law) is a key tool of government to defend the market, both from businesses which try to become monopolies or from businesses which, in coordination with other businesses, try to eliminate competition through cartel behavior.

Though it may seem counter-intuitive, by restricting some market activity, Antitrust can achieve an end goal of lowering consumer prices, a possible end goal of governance. Antitrust can also achieve the end goal of avoiding the accumulation of damaging power in the hands of few corporations which try, sometimes in corrupted way, to control the economy. This short essay endeavors to shed light on the important role of Antitrust, its evolvment and possible application in Energy market, and how it might serve the common strategic goal of Sino-Israel cooperation.

A helpful metaphor may be to think of Antitrust as the "gatekeeper" to the house of the economy. This "house" of national economy belongs to the government and its people. Guests-market suppliers- are invited to the house, to participate in the economy and offer their products to consumers, and competing one with the other on the choices and money of consumers. Competition between suppliers should yield the best and cheapest products to consumers. Yet there is a danger - once in the house, invited guests may try to do as they please. That might involve collaboration between themselves to avoid competition. It could even involve uniting activities against the interests of the host and to the detriment of the house's "tenants"- the public: collaborate and raise prices to consumers, create shortage of products in the market, and avoid competition among themselves by agreement to allocate the markets (geographical allocation or by customers).

Ultimately, Antitrust serves government by ensuring that the invited guest- domestic or foreign- does not control the most important rooms in the house of the economy, belonging to the government and its people.

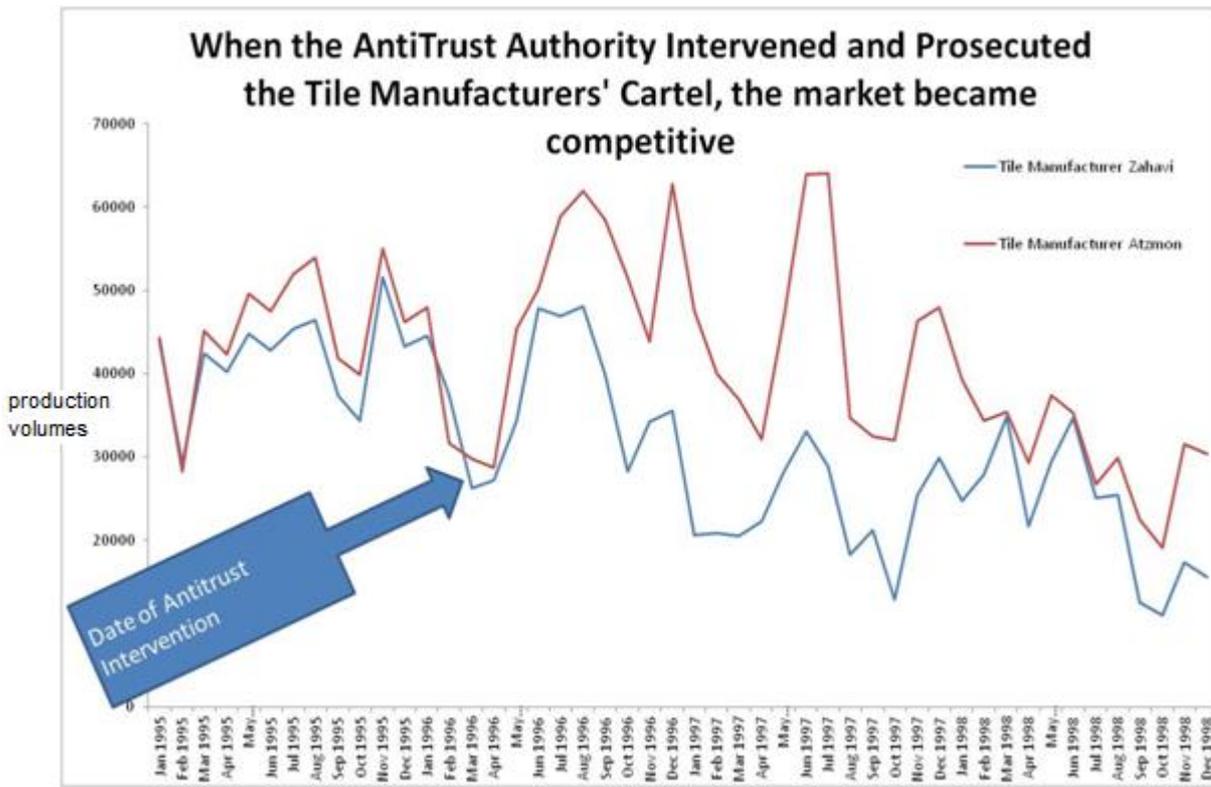
Antitrust ensures that these "guests"- market suppliers - do not form cartels or act as monopolies and damage the public interest by elevating prices, creating shortages and repressing innovation. To clarify, a cartel is an explicit agreement amongst suppliers of products to fix high prices, avoid competition and reduce production. A monopoly is a specific enterprise which is the sole supplier of a particular commodity in a territory (sometimes after it has taken over its competitors, or after it has conspired with them).

Antitrust serves government by ensuring monopolies and cartels do not penetrate governmental institutions and centers of power. In some countries, creating cartels or monopolizing the market are considered a severe violation of the law and offenders are expected to (and sometimes actually are) incarcerated.

Antitrust Action in Israel

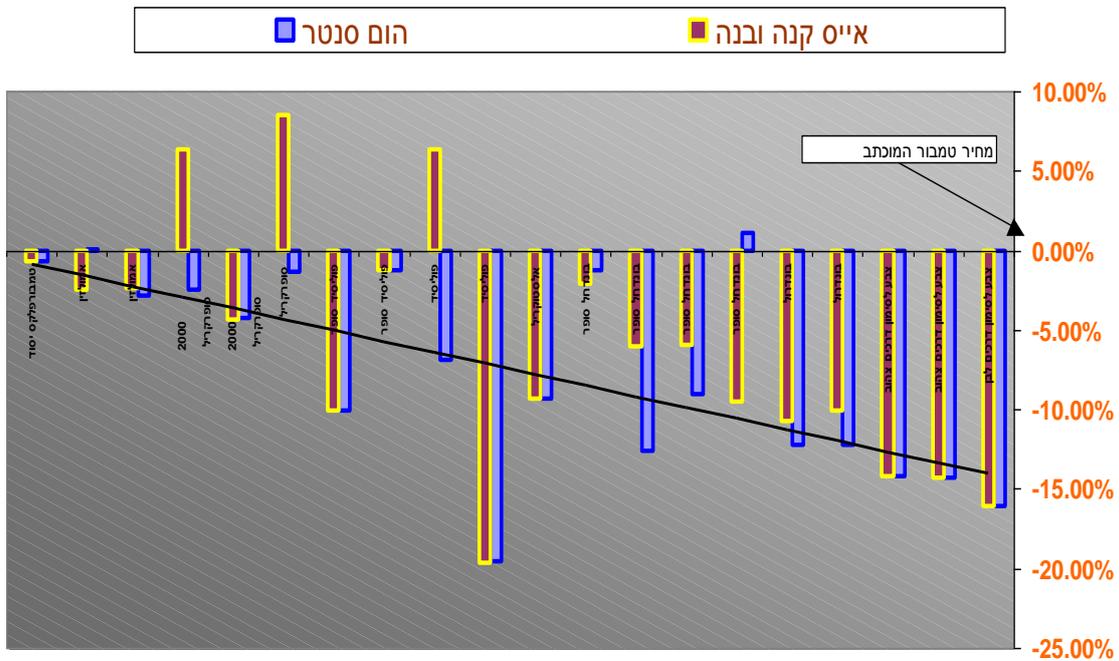
Most capitalist countries have an Antitrust Authority, a government institution empowered to prosecute and incarcerate cartels and monopolies. The Antitrust Authority's goal is to defend consumers from harm, particularly overcharging the public. A case study in Israel illustrates this point. In 1996 the Israeli Antitrust Authority uncovered evidence of a written cartel agreement, in place 14 years, controlling tiles prices, nationally. The members of this cartel were suppliers who together held approximately 85% percent of the tile market. The Antitrust Authority discovered the "plot" and prosecuted. The guilty were incarcerated with sentences of up to 18 months. Intervention immediately made the market more competitive, prices of competing tile manufacturers diverged and production increased. That significantly lowered prices to consumers. Similar cartels were discovered amongst food producers, telecom infrastructure producers, construction and plumbing accessories suppliers, insurance companies, banks and many other areas of the economy.

The case of the Israeli tile cartel illustrates the point that buying from cartels is never cheap. Because they can, cartels overcharge, reduce production, avoid competition and bar new competitors from entering the market. Cartels mostly act in secret; so the public consumer may believe there is competition and does not recognize coordinated actions against their interests. Put simply, cartels are a plot against the public. In addition, cartels may manipulate prices, to increase market power. Over time, these actions transfer wealth from consumers to the cartel members. That elevates the cost of living to the public, lowers living standards and- as has been seen in the last few years- can trigger civil unrest (which in turn may weaken government institutions). Cartels operate intensively in countries that experience rapid economic growth. Israel, for example, experienced significant unrest in the year 2011, when nearly half a million citizensⁱ⁻ⁱⁱ- one in twelve of Israel's working age population- took to the streets in protest of lower living standards. This had a huge political impact. Some commentators believe this continued civil dissatisfaction could ultimately threaten institutions of State.



Source: The Israeli Institute For Economic Planning

Antitrust Authority intervention in the Paints Market led to a significant price decrease



The growth of Monopolies and Cartels

Of course, no nation is immune from cartels and monopolies – they exist in every country around the world. Monopolies are not fundamentally illegal; only when monopoly is reached through the "swallowing" of competitors or when it exploits consumers - it becomes illegal.

Modern monopoly companies are familiar names– examples include Google (with 98% of the mobile search market (iii); Microsoft (around 90% market share of operating systems)iv ; and Facebook (the largest online social directory with over 1.2 billion subscribers).v In the past, IBM, Acad and Intel were monopolies.

Monopolies and cartels tend to grow rapidly at the start of any new industry. It is no coincidence that the monopoly companies mentioned above are internet companies; the Internet age industry emerged recently and grew very rapidly. Rapid industrial growth is a ripe opportunity for cartels and monopolies to form, since increased capacity enables market power to be leveraged. When there are relatively few peer companies that can compete at the same quality, dominant market players thrive.

Antitrust Evolved During Rapid Industrialization in the United States

This insight helps explain why Antitrust, monopolies and cartels all emerged rapidly in the golden period of industrialization in the United States. From 1820 to 1950, GDP per capita in the United States grew year-on-year by almost 2%, far more than the global average^{vi}. Many monopolies, still dominant today such as General Electric, Coca Cola and Dow Chemicals – were created in that period. It is interesting to note that China's growth to 2020, measured by GDP per capita increases, is projected to average by an annualized 9%^{vii}, much more than the growth enjoyed by the United States at the height of its industrialization. This indicates that in the next 7 years, China may be particularly exposed to foreign cartels and monopolies, by virtue of rapid economic growth.

The US case of the banker JP Morgan is most instructive. JP Morgan, the supreme banker of Wall Street, was said to be so influential that his backing of a company was more influential than the financial prospects of the company itself. JP Morgan's legacy was also regulatory: in 1907 the United States suffered a massive recession with numerous runs on banks. JP Morgan personally gathered the most influential leaders in finance and politics to his mansion, and forced them to negotiate and solve the crisis. The power of this one man over the entire economy greatly concerned the US government, leading it to form Federal Reserve Bank.

The Helping Hand, Uncle Sam and JP Morgan rowing



Source: Puck Magazine, 26th April 1911

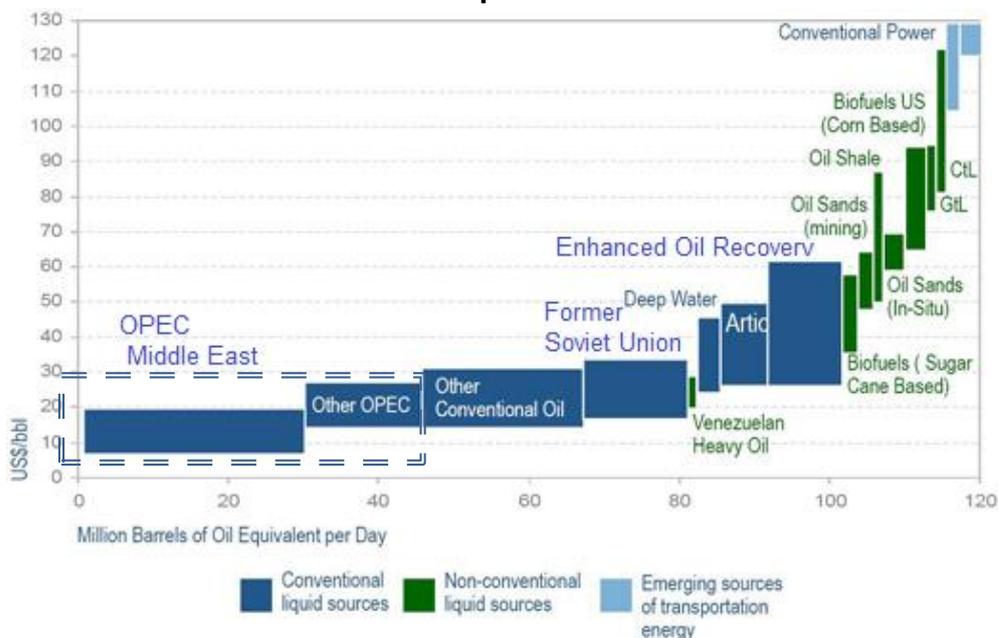
Yet J.P. Morgan's vast power is dwarfed by that of the oil baron John D. Rockefeller. Rockefeller's Standard Oil Company controlled 90% of the American oil industry.^{viii} Standard Oil paid employees minimal wages, purchased assets of competitors it had bankrupted by selling oil at lower than cost from the creditors and then hiked up oil prices to get more market control. Rockefeller's power extended over the transportation supply chain, from crude oil to refining to railroads. The US government eventually took Antitrust action, breaking Rockefeller's holding company to smaller companies, in 1911. The descendent companies of Standard Oil are familiar today- they include Chevron, Exxon Mobil and ConocoPhillips.

The supreme power of the oil baron Rockefeller over the United States leads the discussion to energy cartels, particularly oil cartels, which are of special interest to Sino-Israel common interests. Oil cartels and energy are an area of specific focus at our Institute.

The Strategic Importance of Energy Cartels and Oil Cartels in Particular

A useful observation is that energy cartels- cartels which control oil, gas or coal- are of strategic national importance. Energy has a special role in the economy; it fuels industry and it is a basic consumer need. Energy consumers, indifferent to the energy source and simply focused on increasing consumption or output naturally tends to be focused on energy acquisition. The energy commodity is like oxygen to a growing economy. It is a vital product which, if withdrawn, could choke the economy itself. This is even more the case in a rapidly growing economy, where rapidly increasing capacity tends to leave an open door for energy cartels to enter and gain more power.

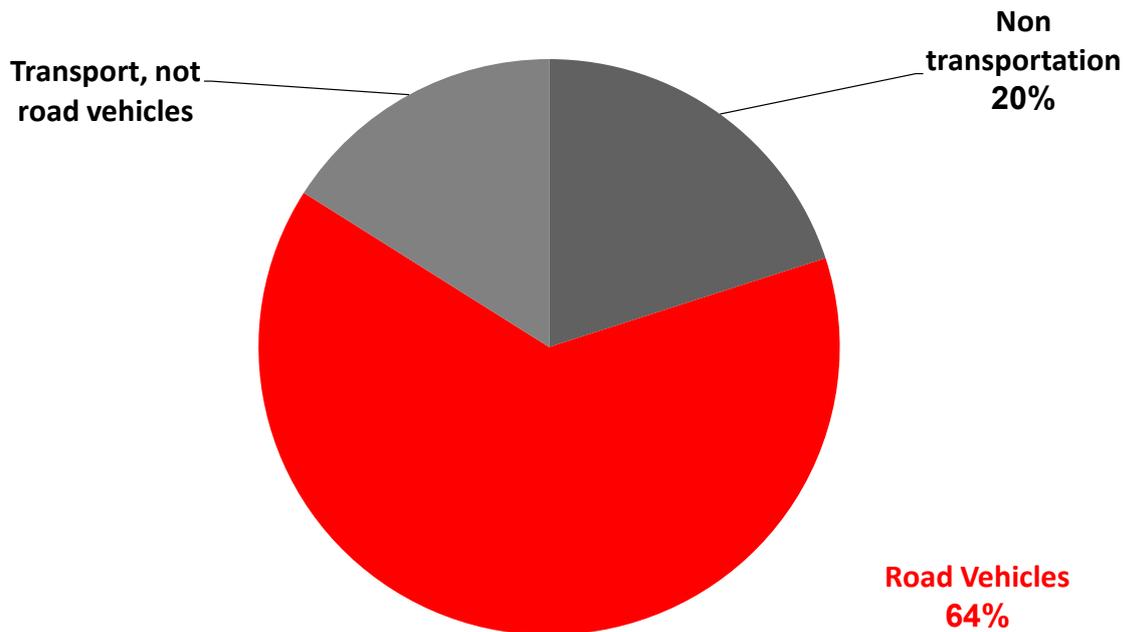
OPEC Cartel Market Power: the cartel can produce oil for less cost, and at greater volume than other oil producers



Dean Fantazzinia, b, c, Mikael Höök, André Angelantonie, Global oil risks in the early 21st century , Energy Policy, Volume 39, Issue 12, December 2011, Pages 7865–7873 December 2011

The global oil market today is controlled by the OPEC oil cartel. OPEC is currently led by Saudi Arabia, whose leadership is contested by Iran, an oil hawk known to want the oil price at a higher level, to finance its government budget. The OPEC cartel— particularly the Middle Eastern component - enjoys very cheap oil production costs, compared to other oil producers. For this reason, US oil and unconventional oil will not, unfortunately, save the world from the continued dominance of the OPEC oil cartel, now, or in years to come. Because Middle Eastern OPEC oil belongs to governments, Antitrust considerations of the oil cartel are no longer a purely commercial issue; they are a tricky geopolitical strategic issue.

Oil is Dependent on Transportation



6

*Approximate numbers from global data, IEA, EIA
Allocation to end sector depends on type of crude oil distilled from various geographic locations*

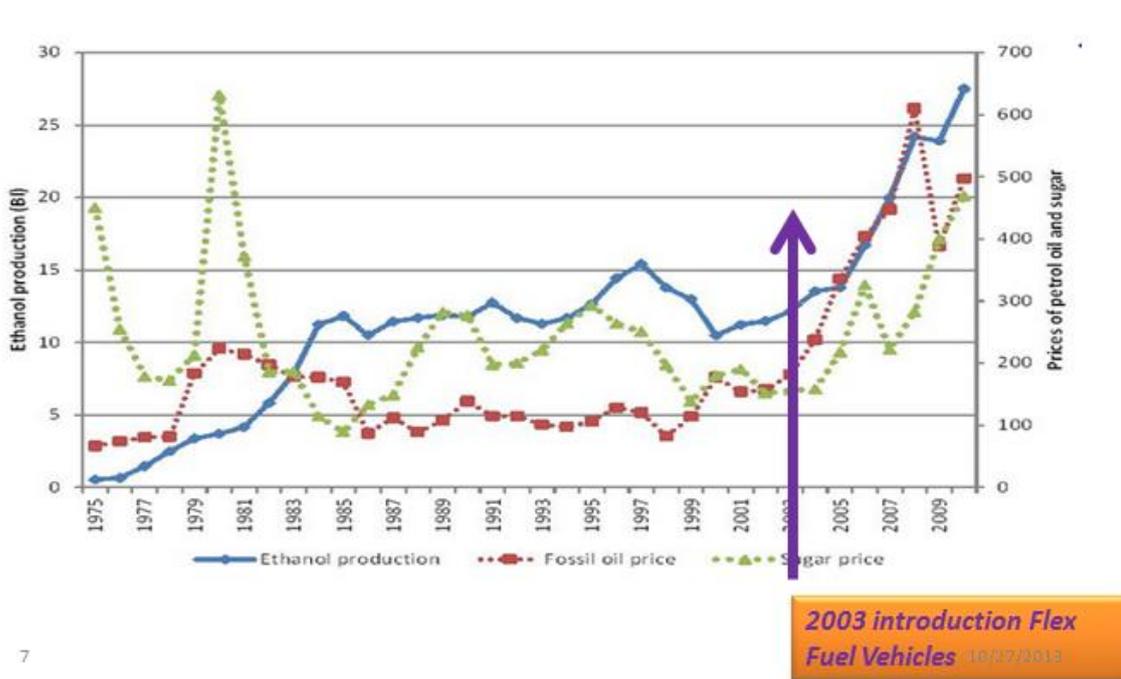
Nearly every country in the world participates in global trade. That and increased transportation are set to increase in years to come; this in turn will increase OPEC's power. Around two thirds of oil produced globally is ultimately used in road transportation and virtually all road transportation is oil dependent. Thus the weakest link in global oil dependence is oil-based transportation. When oil dependence in road transportation ceases, the power of the OPEC' cartel will be weakened. If not, the global economy will increasingly be exposed to the OPEC oil cartel.

Global oil dependence has multiple negative consequences which cannot be outlined in full here. Suffice to mention that 10% of the US debt was from funding wars in Afghanistan and Iraq; ^{ix} that the World Bank acknowledges that oil prices drive food prices^x, and other researchers confirm that food price increases drive civil unrest, on a global scale^{xi}.

Ongoing policy work to reduce the power of the OPEC Cartel: Fuel Choice as a Transformational Approach

Our Institute is currently proceeding with an important Sino-Israel research project which focuses on how could reduce global oil dependence. This body of work identifies four main areas for cooperation; flexible fuel choice, fuel standards, vehicle standards and technology. Of these policy measures, fuel choice is perhaps the most strategically important and interesting. Of the whole world, only Brazil is oil independent and free from the OPEC cartel. Brazil's success stands on their strategy of enabling flexibility choice, at the vehicle tank. That enabled competing, non-

oil based fuels to enter the fuel market. This action cut fuel costs, making its citizens richer. Within just seven years, consumption of oil based fuels dropped by 50%.xii



Source: UNICA, The Brazilian Sugar Cane Association

Fuel choice can profoundly impact national security. The fuel choice policy option, so successful in Brazil, might be applied to other energy markets; for example, it could be transferred to the electricity market. Electricity power stations could adopt non-oil based fuels, such as methanol, as a secondary fuel. Doing that would weaken the market power of energy cartels the power station is otherwise dependent on. Already in Israel there is developmental work which involves using methanol fuel to generate electricity as an alternative to natural gas.

Flex Fuel system is the most powerful guardian against the monopoly and power of oil companies and other dominant players from abroad, who try to "take over" and control energy markets, especially in countries that experience rapid and massive growth. Flex Fuel system puts the power in the hands of the public, consumers, who get to pick the most competitive for them, among oil based products and methanol or other natural gas based products. It ensures that no specific energy products shall become a monopoly.

Conclusion

As this paper has discussed, Antitrust is an important "shield" for the government to protect the public and the national economy from "hostile takeover" from dominant corporations who might try to monopolize and cartelize the markets. Antitrust considerations indicate strategic goals for Sino-Israel cooperation. Both China and Israel wish to grow their economies and provide stability and prosperity for their citizens. A peaceful economic rise for both countries necessitates continued exports, supported by strong domestic and global economy and unhindered by a rising and volatile oil price.

The Chinese government is currently engaged in building and guarding its "house of the economy". In this era of rapid growth in the economy and transport, it is suggested that a certain mindfulness is adopted as to which unwelcome foreign guests may enter through the door. Such unwelcome foreign guests may not be beneficial to China's peaceful rise. Of particular concern are the foreign energy cartels whose members are nationalized companies. History has shown that trading partners who are governments, dependent on petro revenues for their continued survival, can result in trade disputes escalating to geopolitical and security tensions which are inescapable, due to deeply embedded trade dependencies.

The People's Republic of China is vast- the second largest country in the world, a population of over 1.3 billion and more than 100 million middle class. ^{xiii} The State of Israel, by contrast, has a population just over 8 million and the area of the entire country is around 25% more than the Beijing Province.^{xiv} The two countries have different domestic economic models. There is much Israel may learn of China and its institutions.

It is essential both China and Israel continue to prosper in the globalized economy. Neither country can afford to allow participation in the globalized economy to expose us to domestic disturbances due to the unwelcome guest of oil or other energy cartels.

Neither Israel nor China would benefit from a more powerful OPEC cartel, continued oil dependence or what looks like inevitably more expensive and volatile oil prices in future. Unless policy action is taken, some options of which are highlighted in our ongoing research, a more powerful OPEC cartel is inevitable, in this era of instability, In the near future, the demise of the King of Saud, a leadership dispute at OPEC, a continued Arab Spring and many other risk factors could push the oil price from \$100 to \$150, or even \$200. That would spell disaster for the global and local economy. Through cooperation this could be avoided.

-
- ⁱ <http://www.ipost.com/National-News/March-of-the-Million-Over-460000-protest-across-country>
- ⁱⁱ http://cbs.gov.il/www/publications/isr_in_n11e.pdf
<http://www.tradingeconomics.com/israel/age-dependency-ratio-young-percent-of-working-age-population-wb-data.html>
- ⁱⁱⁱ <http://online.wsj.com/news/articles/SB10001424052702303830204577448792246251470> Google's Monopoly and Internet Freedom. JEFFREY KATZ, June 7, 2012, The Wall Street Journal and has larger annual revenues than the economies of the world's 28 poorest countries combined
- ^{iv} <http://247wallst.com/investing/2011/03/22/the-new-generation-of-american-monopolies/2/> The New Generation Of American Monopolies, March 22, 2011
- ^{vi} [Historical Statistics of the World Economy: 1-2008 AD, Angus Maddison](#)
- ^{vii} [Historical Statistics of the World Economy: 1-2008 AD, Angus Maddison](#)
- ^{viii} <http://ech.case.edu/cgi/article.pl?id=BA>
- ^{ix} <http://www.whitehouse.gov/infographics/us-national-debt>
- ^x John Baffes, Allen Dennis, 5/ 2013 Long-Term Drivers of Food Prices The World Bank Development Prospects Group & Poverty Reduction and Economic Management Network Trade Department Policy Research Working Paper 6455
- ^{xi} Marco Lagi, Karla Z. Bertrand and Yaneer Bar-Yam, 8/ 2011 The Food Crises and Political Instability in North Africa and the Middle East Cornell University
- ^{xii} [UNICA Brazilian Sugar Cane Association](#)
- ^{xiii} Communiqué of the National Bureau of Statistics of People's Republic of China on Major Figures of the 2010 Population Census[1] (No. 1(National Bureau of Statistics of China 2011-04-28 10:18:04)
http://www.stats.gov.cn/english/newsandcomingevents/t20110428_402722244.htm
- http://en.wikipedia.org/wiki/Provinces_of_China^{xiv}