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The Return of Cartels?

De-globalization and Decoupling: The Return of the Cartel as an International Governance System?

What new organizational forms and governance systems will emerge to allow companies to compete within and across distinctly different and possibly hostile geo-economics and geopolitical systems? The argument of this piece is that the trend towards bifurcated governance of the global economy and the rise of techno-nationalism will lead to the return of the cartel as a mode of corporate governance. Regulatory competition between states has heretofore been largely tax-induced with tax havens competing for economic activity by reducing fiscal demands on corporations but now regulations have become protectionist, designed to prevent activity across the fracture in the global economic system between the USA and China.

Cartels

The multinational enterprise (MNE) and the cartel are alternative institutional arrangements for the exploitation of international monopoly power. A cartel is an institution for implementing an agreement for the maintenance of prices or the limitation of outputs of independent producers. (Casson 1985). The products have to be substitutes for such an arrangement to work. Cartels can be voluntary associations or Government mandated. They coordinate collusive behaviour and are particularly effective where there are obstacles to trade. Protection of national markets in whatever form - tariffs, quotas, bans, security concerns, prohibitions on inward foreign direct investments (including approval bodies such as CFIUS) all favour cartels over unified ownership MNEs. Where there is a high risk of expropriation, cartels reduce risks.

Cartels are most effective where there are few sellers and a high minimum efficient scale of operation. This includes manufacturing industries with economies of scale (microchips), mining industries where raw materials are geographically concentrated, transport including long-distance freight (volatile demand, rigid capacity constraints, long run economies of scale) and infrastructure. Cartels are least effective where products are varied, technology is rapidly changing, and where there is relatively easy entry from outside the sector. Cartels need to cope with costs of communication between the members and information costs. Cartels are likely to break up when innovation threatens their monopoly, and where integration into a global MNE is optimal following the end of obstacles to internalization.

In the short term, cartels can take the form of informal undertakings, price fixing quotas, pooling associations and associations for allocating contracts. In the medium term, cartels can take transitional forms such as sales syndicates, cartels with a dominant focal firm leader, or financial communities of interest. In the long term, trusts and holding companies mimic integrated multi-plant firms (Robinson 1941). Alliances between companies are sophisticated forms of the cartel, controlling “choke points” in global product and service flows. Alliances too are flexible as regards longevity, and can be defined for a fixed period, or until a specified goal is achieved, or can be time-unlimited. Cartels can be informal or covert rather than being transparent and legally defined. There may be a premium on private equity ownership, rather than public quotation in the organization of cartels.

In the bifurcated world, cartels can take the form of local sales monopolies, organised systems of licensing and cross-licensing, and systemic contract allocation as well as new forms of holding companies. In the face of rising VUCA (volatility, uncertainty, complexity and ambiguity), collusion reduces unfavourable outcomes. International cartels link domestic multi-plant firms to replicate an MNE. Global dominance can follow a two-stage hierarchy of collusion – domestic monopolies colluding by entering a global cartel. This restores pre-fracture profitability by raising prices. Consequently, we may see tacit collusion and concealment to circumvent the fracture and avoid regulation. Working across political divides may result in new strategies and the science of business subterfuge may reach new heights.

Cartels and GVCs

GVCs are not necessarily benign. They can be anti-competitive, closed and opaque. Systemic contract allocation constitutes the cartelization of supposedly competitive GVCs. The duplication of GVCs across "the fracture" in the global economy does not necessarily increase competition if contracts are allocated by a ruling cartel that can operate across any, and all, levels of the GVC. Information sharing on contracts, bidding and choice of contractor cartelizes global trade. Competitive bidding can be eliminated by an effective cartel – bid rigging across GVCs is an effective rent seeking tactic. Supporters of cartels argue that they eliminate "wasteful competition".

Standardization and the enforcement of standards are a form of cartelization. The imposition of standards, and charging for the use of such standards and for certificates of compliance substitute for direct control of unrelated enterprises. There are many opportunities in global GVCs to gain rent from certification. Such opportunities are likely to multiply as polities become fragmented across boundaries. Standards travel across politically fragmented markets and present a growing opportunity for profit. Wars in standards, particularly in high-tech areas due to the decoupling of the world economy create further opportunities for cartels.

Holding Companies

High transaction costs induced by the fracture in the global economy can be countered by financial architectures to conduct institutional arbitrage across the fracture by creating holding companies. If the holding company can be located in a "neutral country", it can internalize financial linkages and operate across the fracture. Holding companies based in one side of the divide may be easy targets for discrimination. Sanctions against companies from the other side of the divide may require subtlety, even subterfuge. Collusive behaviour across the fracture can include informal agreements, information sharing, market allocation and financial support. The intensification of the digitization of business enables the growth of international holding companies by means of "e-registration" that effectively allows multiple international corporate residencies.

Cartels enable (Chinese) companies to improve corporate governance by establishing affiliates in territories with high governance standards, and then diffusing the operational experiences throughout the cartel.

Many emerging countries are hosts to "business groups" that have some characteristics of cartels although these are sometimes more transparent than the covert cartel. The management of such groups, using informal (often family) links is instructive in the organisation of holding companies and may provide competitive advantages in a new cartelized world economy.

Quotas are a means of earning rent by reducing supply and increasing prices. They are amenable to implementation across regulatory boundaries and tariff –divided economies and are a means of implementing discriminatory pricing in the absence of joint ownership

Financial Flows

Foreign Direct Investment (FDI), the major global strategic weapon of the MNE, is a package of resources including, technology, management skills, organizational control and finance. Unbundling this package and relying on pure financial flows enable owners of capital to circumvent controls on ownership. The cartel, a web of disguised control, utilizes cross-border flows of finance to mimic MNEs in the fractured world economy. Cross-shareholdings can achieve coordination similar to management fiat in integrated MNEs. Institutional investors control formal or informal holding companies across the fracture. Purchasing onshore bonds may be permitted to foreign entities, and offshore bonds are designed for multinational ownership. Similar purchases of bonds in private, government and state owned companies also achieve the international diversification of assets by a holding company. These financial flows are increasing currently and represent the substitution of the MNE by newer cartels. These cartels list parts of their network on foreign stock markets, both to raise capital and for corporate learning and further internationalization moves. Chinese companies for instance, continue to list on American stock markets.

Technology and Patent Cartels

Techno-nationalism implies the national control of technology and its corollary is that high-, innovative and security related technology should not "leak" outside the nation that "owns" or "creates" the technology – implicitly, the country of innovation. Technology is both fungible and non-location bound. Restrictions on the spread of technology creates incentives to capitalise on monopoly or quasi-monopoly given by patent protection. We can thus expect largely covert cartels in technology transfer across boundaries and regulatory regimes. The downside risk of such activities (getting caught) will be high, but so potentially are the rewards. "Pirate" technology providers are set to prosper, smuggling technology across political divides. Systemic theft of technology was a feature of pre-fracture globalization and it looks set to escalate, but perhaps by the use of covert cartels this time.

The Splinternet

Data is a key commodity in the modern world. The control of data is a key target of Governments and corporations. The rise of the internet made data on private individuals a key battleground between companies and Governments. Much of this information was granted free to tech companies in the initial stages as a return for connectivity, privileged access to rewards, and price reductions. Now its value is recognised and possession has become much more contested. Access to the private data of one country's national by foreign companies and Governments caused political consternation and fuelled protectionism. Political interventions, including "the Great Firewall of China", have splintered the previously largely globally integrated internet into several politically determined domains. However, cross holdings, the existence of shared interests, and information exchange are the beginnings of partial coordination across the fracture and the potential rise of cross-fracture internet cartels. Duplication of channels is always an incentive to the formation of cartels and this is no exception. There are huge incentives in bridging divides in communication hardware and software and, with overt ownership not politically possible, cartels become optimal solutions.

Conclusion

If the fracture in the world economy persists and techno-nationalism further divides national polities, we can expect the cartel, as an organizational form, to begin to supplant integrated multinational companies. This will require radical revision of existing anti-trust, anti-monopoly legislation and the need to revise international competition rules. Ownership will no longer be an indicator of control. Regulatory vigilance will need to be upgraded to seek out the more sophisticated anti-competitive nature of the cartelization of the emerging splintered economy.

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