

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON COMPETITION IN THE CONSTRUCTION INDUSTRY

-- Note by the United States --

This note is submitted by the Delegation of the United States to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 11-12 June 2008.

JT03246717

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format



1. Introduction

1. Construction is an important sector of the U.S. economy, accounting for about 5 percent of gross domestic product. In 2002, over 7 million individuals were employed in construction, and the value of all construction work done was \$1.2 trillion. Small businesses are the mainstay of some segments of the construction sector. For example, establishments with fewer than 50 employees account for more than 70 percent of the value of single-family housing construction.

2. Construction is a highly diverse sector. It encompasses all sorts of buildings: residential, commercial, and industrial. It encompasses all sorts of civil engineering projects: streets and highways, bridges, water and sewer lines, dams and power plants, and so forth. And it encompasses all sorts of trades involved in each of the foregoing: carpentry, concrete, electrical, excavation, flooring, framing, masonry, roofing, painting, plumbing, and so forth.

3. Construction also is diverse with respect to matters relevant in competition policy. Competition in the construction sector commonly is highly localized, but for some large projects, the geographic scope of competition may be national or international. Most relevant markets in the construction sector have low levels of concentration, but concentration may be very high in sparsely populated localized markets as well as in highly specialized types of construction, such as large suspension bridges, for which highly specialized skills or equipment are required. Similarly, entry into most construction markets is easy, but for certain types of specialized construction, entry may be quite difficult, in particular because a record of success may be essential to be a viable competitor.

2. Antitrust Enforcement

4. The construction sector has been significant historically for U.S. antitrust enforcement. During the 1980s, the U.S. Department of Justice brought roughly five hundred criminal cases involving bid rigging in construction. (Because multiple cases are often filed against a single cartel, the number of distinct cartels was substantially less than five hundred.) These cases involved many different types of construction, but the vast majority involved public procurement, and about two-thirds involved road building.

5. Public procurement in general, and road building in particular, have in the past proven susceptible to bid rigging for two reasons. First, contracts were sufficiently numerous, or sufficiently divisible, that it was feasible to allocate a portion of the work to each conspirator. Second, public procurement rules designed to avoid corruption by adding transparency to the process provided information important in policing compliance with the cartel agreements. A deviation from an agreed upon allocation was detected both immediately and with certainty when the successful bidder on a contract was announced and its bid made public.

6. Although the road building industry continues to have characteristics that make bid rigging feasible, active enforcement with significant penalties, along with education of procurement officials, clearly have had a significant deterrent effect. During 1990–2003, the U.S. Department of Justice did not bring a single case involving road building, even though the Department was prepared throughout that period to investigate all credible allegations of bid rigging. With respect to bid rigging in road building, and public procurement in general, the record indicates that cartel enforcement generally has had the desired deterrent effect.

7. The Department has had one recent successful prosecution of a road-building cartel. The cartel rigged bids on a series of projects in Wisconsin costing more than a total of \$100 million. In 2004 indictments were handed down for two companies and four executives. In 2005 the companies and their

executives pled guilty; fines and restitution totaled \$3.1 million, and the executives were sentenced to 882 days of incarceration and 635 days of house arrest.

8. Excluding cases involving road building, the U.S. Department of Justice has brought twenty criminal cases in the construction sector since the beginning of 2000. The cases involved a wide variety of construction projects, including natural gas pipelines, suspension bridges, and wastewater treatment facilities. In addition, the Department had a significant price-fixing prosecution in ready-mix concrete in Indiana, which yielded the largest ever fine imposed on a single defendant for purely domestic cartel activity (\$29.2 million).

9. The Antitrust Division of the U.S. Department of Justice often prosecutes crimes under federal statutes other than the antitrust laws. A recent group of related cases concerned bribery of a government official overseeing a \$3 billion repair and rehabilitation effort for sewer and wastewater treatment facilities in Alabama. Sixteen individuals and five corporations were convicted at trial and sentenced to substantial terms of incarceration, of up to 8 ½ years. In another case, one individual pleaded guilty to accepting a bribe when he was a federal official overseeing a levee construction project.

10. 1. In recent years, the U.S. enforcement agencies have not challenged any mergers in the construction sector.

3. “Ruinous Competition” and the Antitrust Laws

11. The contention that competition in particular settings would be “ruinous” was commonly heard in the 19th Century. The contention that competition between privately owned bridges would be ruinous was made before the Supreme Court of the United States in 1837, in a non-antitrust context.¹ By the late 1800s, notable U.S. economists had expressed the view that demand and cost conditions could be such that price competition among several rivals would prevent each from earning a competitive return, and these arguments were frequently made in the courts.² After the Sherman Act became law in 1890, the Supreme Court addressed, and rejected, the contention that ruinous competition should justify otherwise unlawful price fixing by railroads.³

12. In the 1940 Supreme Court decision that crystallized the per se rule against price fixing, the Court rejected the argument that the challenged conduct was a reasonable response to the ruinous competition alleged to exist in the petroleum industry. The Court held that the Sherman Act did not permit the courts to consider such arguments: “Congress has not left with us the determination of whether or not particular price-fixing schemes are wise or unwise, healthy or destructive. It has not permitted the age-old cry of ruinous competition and competitive evils to be a defense to price-fixing conspiracies.”⁴

13. In the first half of the 20th Century, the mainstream view among U.S. economists was that competition generally worked, although ruinous competition was possible.⁵ Railroads were the one

¹ *Charles River Bridge v. Warren Bridge*, 36 U.S. 420, 436, 461 (1837).

² See HERBERT HOVENKAMP, *ENTERPRISE IN AMERICAN LAW, 1836–1937* ch.23 (1991); Herbert Hovenkamp, *The Antitrust Movement and the Rise of Industrial Organization*, 68 *TEXAS LAW REVIEW* 105, 129–36 (1989).

³ *United States v. Joint Traffic Association*, 171 U.S. 505, 576–77 (1898); *United States v. Trans-Missouri Freight Association*, 166 U.S. 290, 330–31 (1897).

⁴ *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221 (1940).

⁵ See, e.g., John Maurice Clark, *Toward a Concept of Workable Competition*, 30 *AMERICAN ECONOMIC REVIEW* 241 (1940); Eliot Jones, *Is Competition in Industry Ruinous*, 34 *QUARTERLY JOURNAL OF ECONOMICS* 473 (1920); Lloyd G. Reynolds, *Cutthroat Competition*, 30 *AMERICAN ECONOMIC REVIEW*

example of an industry subject to ruinous competition to which economists consistently pointed.⁶ In the late 20th century, that example was challenged,⁷ and U.S. railroads were substantially deregulated without outbreaks of ruinous competition. Modern economic theory continues to recognize the possibility of ruinous competition,⁸ but leading U.S. scholars of economic regulation now view ruinous competition as an empty box—a theoretical construct without a real-world counterpart.⁹

14. An auction scenario arising in the construction sector can be associated with a different phenomenon that could possibly be considered ruinous competition. This scenario is the “first-price” “common value” auction. In a first-price procurement auction, the low bidder is awarded the contract at amount bid. In a common-values procurement auction, the cost of performing the contract is common to all bidders, but is uncertain, and bids are based on estimates. This sort of auction is said to give rise to the “winner’s curse.” Bidding estimated cost, on average, results in a loss because the lowest of several independent estimates of the true cost, on average, is less than the true value. Economists, however, argue that rational bidders avoid the winner’s curse by bidding above their cost estimates, allowing a margin of error.¹⁰ Moreover, interviews with construction executives revealed that mechanisms had evolved to escape the winner’s curse or mitigate its impact and that experienced professionals could estimate costs very accurately, thereby eliminating the risk of any significant winner’s curse.¹¹ In our view, the possibility of a winner’s curse should play no role in cartel enforcement in the construction sector.

15. A final contention sometimes made under the general rubric of ruinous competition is that price competition can be undesirable because it leads to an erosion of quality and perhaps even undermines public safety. Reflecting on widespread collusion in his country’s construction sector, a Dutch academic recently opined: “Highly competitive environments might even lead to ruinous competition and ‘a race to the bottom,’ leading to problems with quality, safety, and compliance with the law.”¹²

16. The Supreme Court has addressed the possibility of this sort of allegedly ruinous competition. The case involved an agreement among consulting engineers to refrain from competitive bidding on contracts for the study, design, and construction of bridges, buildings, and other projects.¹³ The engineers argued that competition on price “would adversely affect the quality of the engineering” and “would be dangerous to the public health, safety, and welfare.”¹⁴ The Court rejected this “frontal assault on the basic policy of the Sherman Act,” explaining that:

The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services. The heart of our national

736 (1940).

⁶ See, e.g., D. PHILIP LOCKLIN, *ECONOMICS OF TRANSPORTATION* 150 (7th ed. 1972).

⁷ See Richard C. Levin, *Railroad Rates, Profitability, and Welfare under Deregulation*, 12 *BELL JOURNAL OF ECONOMICS* 1 (1981).

⁸ See, e.g., LESTER G. TELSER, *A THEORY OF EFFICIENT COOPERATION AND COMPETITION* ch.5 (1987).

⁹ See STEVEN BREYER, *REGULATION AND ITS REFORM* 29–32 (1982); Roger G. Noll, *Economic Perspectives on the Politics of Regulation*, in 2 *HANDBOOK OF INDUSTRIAL ORGANIZATION* 1253, 1257 (Richard Schmalensee & Robert D. Willig, eds. 1989).

¹⁰ See, e.g., PAUL KLEMPERER, *AUCTIONS: THEORY AND PRACTICE* 13–14, 53–55 (2004).

¹¹ See Douglas Dyer & John H. Kagel, *Bidding in Common Value Auctions: How the Commercial Construction Industry Corrects for the Winner’s Curse*, 42 *MANAGEMENT SCIENCE* 1463 (1996).

¹² A.G. Dorée, *Collusion in the Dutch Construction Industry: An Industrial Organization Perspective*, 32 *BUILDING RESEARCH & INFORMATION* 146, 153–54 (2004).

¹³ *National Association of Professional Engineers v. United States*, 435 U.S. 679 (1978).

¹⁴ *Id.* at 685.

economic policy long has been faith in the value of competition. . . . Even assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad.¹⁵

17. The U.S. antitrust agencies believe that governments and other consumers of construction work can reap the benefits of competition without risking public safety. The procurement process has addressed public safety concerns by incorporating detailed requirements in the bid specifications and by accounting for both price and performance in awarding contracts. In addition, public safety has been addressed directly by adopting and enforcing building codes and similar regulations.

¹⁵ *Id.* at 695.