

# **Transparency, Collusion and Corruption in public procurements**

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# Issues to be discussed

1) Competition issues in government ICT services

Supply side issues

Demand side issues

2) Competition and public procurement

Short term issues

Long term issues

3) Corruption and public procurement

4) OECD recommendations on public procurement, collusion and corruption

## **Press releases 2013 -**

### **OFT launches call for information into supply of Government ICT services**

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The OFT has today launched a call for information into the supply of information and communication technology (ICT) goods and services to the public sector and is calling for suppliers and purchasers to get in touch about their experiences.

ICT plays a crucial role in the delivery of all public services, including schools, hospitals and the police. It is also an important part of the UK economy, with the top 20 software and IT services providers earning about £10.4bn a year in revenue from the public sector.

The OFT is keen to ensure that competition in this sector works well. Healthy competition in any market drives down costs, drives up efficiency and promotes innovation, while a lack of competition can hinder productivity and, in turn, economic growth.

The OFT is particularly seeking information about:

- The structure of the sector, for example the number of suppliers and their market share.
- Whether there are barriers to entry which make it difficult for smaller businesses to compete in this sector.
- Whether public sector users face high barriers to switching suppliers, such as costs of transferring and restrictive licence agreements.
- Whether some suppliers seek to limit the interoperability and use of competitor systems with their own.
- Whether outsourcing of ICT service provision results in a high level of dependence on suppliers' expertise, undermining the ability of public bodies to drive value for money over time.

There have been many reviews of the procurement of ICT by the public sector yet few studies have examined whether aspects of the supply side of the market inhibit competition. The OFT's review aims to address this imbalance.

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# Competition in ICT: supply side issues

The OFT is particularly seeking information on:

- the structure of the market
- whether there are **barriers to entry** which make it difficult for smaller businesses to compete
- whether public sector users face **high barriers to switching** suppliers, such as costs of transferring and restrictive licence agreements
- whether some suppliers seek **to limit the interoperability** and use of competitor systems with their own
- whether **outsourcing of ICT** service provision results in a high level of **dependence on supplier expertise**, undermining the ability of public bodies to drive value for money.

# **Issues to be discussed**

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# Competition in ICT: demand side issues

9. (...) the project will also examine the **degree to which procurement practices interact with these and whether they could create additional barriers to entry in public sector ICT markets**. Such procurement processes could be creating barriers to entry in various ways including:-

- smaller suppliers being deterred by **overly-long and non-standardised pre-qualification questionnaires**;
- **aggregation / bundling of contracts** acting as a barrier to entry for smaller suppliers
- **framework agreements undermining competition on price by facilitating suppliers coordinating bids** (for example by restricting the number of firms that can win contracts) or deterring suppliers from joining because of the up-front costs involved in joining a framework.

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# Competition effects from public procurement: short term

In the short-term, the main competition effects from public procurement relate to the impact of procurement decisions on:

- the level of participation in a particular tender (limiting participation has a detrimental impact on competition in the short-term, even though there are also good reasons for limiting participation)
- the similarity of bidders (designing procurement processes in a way that ensures that participants are more alike tends to increase competition, whereas processes that lead to participants being very dissimilar are likely to reduce competition).
- the incentives and ability of bidders to engage in tacit collusion (The more likely under-bidding would be detected, the more effective is the threat of retaliation by other firms which ultimately sustains the collusive outcome).

# **Competition effects from public procurement: short term**

A rule of thumb is that more bidders make for more intense competition, resulting in lower prices and better quality.

Even though the incremental benefits from having more participants in a tender may become smaller as the number of bidders increases, in most circumstances adding bidders increases the level of competition.

This suggests that any feature of public procurement processes that limits participation has a detrimental impact on competition in the short-term.

# **Competition effects from public procurement: short term**

Designing procurement processes in a way that ensures that participants are more alike tends to increase competition, whereas processes that lead to participants being very dissimilar are likely to reduce competition.

This may be particularly important with regard to setting prequalification criteria for restricted tenders, which determine not just the likely number of bidders, but also their characteristics and thus their similarity.

# Competition effects from public procurement: short term

The design of the procurement process can also affect the likelihood of collusion.

Generally, it is more difficult to sustain collusion as the number of bidders increases, and as bidders become more dissimilar (which may counteract the positive impact on competition as a result of more similarity across bidders).

**Transparency:** The more likely under-bidding would be detected, the more effective is the threat of retaliation by other firms which ultimately sustains the collusive outcome.

**Frequency of interaction:** collusion is more easily sustained when bidders interact repeatedly.

**Stability of demand:** collusion is more easily sustained in markets where demand is relatively stable and predictable.

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# Competition effects from public procurement: long term (inc incumbency)

Long-term effects require that changes in market structure and market position caused by short-term restrictions or distortions cannot be easily reversed, and that the threat of potential competition from new entrants is not effective.

Public procurement can have long-term effects on competitiveness by increasing the gap between market leaders and other suppliers, or by creating incumbency advantages for public contractors in future tenders.

If repeated selection of the same firm increases incumbency advantages (e.g. through learning-by-doing, or as a result of specific investments made by the successful bidder), a buyer awarding a contract to the cheapest supplier in a series of tenders may find itself with a rather restricted choice of suppliers in the long term.

Awarding multiple contracts and selecting a different bidder for each of those contracts, even if bidders do not offer the lowest may alleviate the problem.

# **Competition effects from public procurement: long term (bundling)**

Through bundling its requirements, the public sector may also affect the vertical organisation of supply.

Buying bundles of services across the value chain can provide advantages to vertically integrated suppliers, and affect decisions of firms to integrate vertically. But it may also restrict the ability of smaller firms to compete.

Conversely, by insisting on purchasing services unbundled, the public sector might remove or weaken incentives for vertical integration.

# **Competition effects from public procurement: long term ( innovation)**

Where procurement is used in order to promote investment and innovation (as, for example, in the case of public procurement of broadband services, where public demand was initially regarded as one of the main drivers of roll-out), it may determine the range of products available, and the firms supplying them.

Thus, public procurement decisions may be the main factor determining competition in the market at large, having helped to create it in the first place.

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# Bid-Rigging and Collusion

**Collusion** is a relationship between bidders which restricts competition, increases prices artificially and harms the public purchaser.

**Corruption** is first and foremost a principal-agent problem where the agent (the procurement official) enriches himself at the expense of his principal, the government purchaser (or the public more generally).

Corruption arises in procurement when the agent of the procurer in charge of the procurement is influenced to **design the procurement process** or **alter the outcome of the process** in order to **favor a particular firm in exchange for bribes or for other rewards**.

(1) Presentation based on OECD Competition Committee Roundtable “Collusion and Corruption in Public Procurement », OECD 2010

# Collusion, corruption and bid-rigging

(1) *Collusion and corruption are distinct problems within public procurement, yet they may frequently occur in tandem, and have mutually reinforcing effect. They are best viewed, therefore, as concomitant threats to the integrity of public procurement.*

# **Collusion, corruption and bid rigging: A Japanese exemple**

In 2005, the Japanese Fair Trade Commission (JFTC) ordered 45 Japanese steel bridge builders to stop rigging bids for government contracts.

More than 70% of the steel projects for steel bridges given out between 1999 and 2004 by the Japan Highway Public Corporation were won by 47 companies which belonged to two bid-rigging associations.

Their bids were almost exactly the same as the public corporation estimates.

The JFTC also ordered the Japan Highway Public Corporation to improve its bridge contract procurement practices, alleging that some 20 former public officials had been involved in bid-rigging practices to secure future jobs with the 45 companies.

According to one tally nearly 60% of former bureaucrats involved in road work got jobs after they retired with one of the top 10 corporate bodies that do road work.

# **Collusion and corruption: A French exemple**

France – Three major French construction companies, Bouygues, Suez-Lyonnaise and Vivendi were the subject of a major investigation for a scandal which was described as “an agreed system for misappropriation of public funds” (Le Monde, 10 Dec 1998). The three companies participated in a corrupt cartel over building work for schools in the Ile-de-France (the region around Paris) between 1989 and 1996. Contracts worth over four billion Euros were shared out by the three major French building companies.

The system also involved political corruption: a levy of 2% on all contracts was paid to finance the major political parties in the region.

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# **Long standing interest of the OECD competition committee in bid-rigging and corruption**

- OECD Council adoption of a [Recommendation on Fighting Bid Rigging in Public Procurement](#) (2012)
- [co-operation agreement](#) between the Mexican Competition Authority, the Mexican Social Security Institute (IMSS) and the OECD in January 2011 to implement the OECD guidelines
- Rdtable Comp. Com. « Collusion and Corruption in Public Procurement » (2010)
- OECD adoption of the Principles of Integrity in Public Procurement (2009)
- Adoption of the OECD [Guidelines for Fighting bid rigging in Public Procurement](#) (2009)
- Rdtable Comp. Com. “Designing Tenders to reduce Bid Rigging” (2009)
- Rdtable Comp. Com. “Detecting Bid Rigging in Public Procurement” (2009)
- Rdtable Comp.Com. “Fighting Cartels in Public Procurement” (2008)
- Rdtable Comp. Com. Public Procurement; the Role of Competition Authorities in Promoting Competition (2007)

# **Distinctiveness of public procurement**

*The distinctiveness of public procurement and its context makes the process particularly vulnerable to collusion and corruption, while also increasing the magnitude of harm that these offences cause.*

# Effect of bid-rigging on public procurement markets

The effects of collusion and corruption in public procurement

- are arguably more problematic than in private procurement.
- represent wastage of public funds.
- have the heaviest detrimental impact on the most disadvantaged in society, who rely on public provision to the greatest extent
- is detrimental for democracy and for a sound public governance,
- inhibits investment and economic development.

# Fighting bid rigging and corruption

*Tensions between the sometimes competing approaches to the prevention of collusion and corruption within public procurement may necessitate trade-offs to achieve both effectively. For example, while transparency is indispensable for corruption prevention, excessive or unnecessary transparency should be avoided.*

# Transparency and corruption

## Transparency requirements

- allow **scrutiny of public officials'** decisions, reduces the information asymmetries and facilitates monitoring, supervision and control of the procurement process.
- makes bidders accountable and **facilitates detection and punishment of malfeasance.**
- **increases the likelihood that other bidders denounce corrupt activities**, which sends positive signals about trust in the process;
- **helps bidders to avoid the prisoner's dilemma in cases where it is not known if other bidders are bribing or not.**
- also **makes it easier for government auditors to uncover illegal conduct.**

# Transparency and collusion

- Transparency is one of the factors **required for a sustainable collusion**.
- If a limited number of suppliers (public procurements), the effects of information exchanges due to a **transparent procurement process raises significant competition concerns**.
- **Information on the procurement outcome** revealed by the auctioneer can facilitate collusion.

# **Need for an integrated approach to fighting bid-rigging and corruption on public procurement**

- Sound procedural design is necessary to mitigate the trade-off between corruption and collusion with respect to transparency.
- For example, procurement rules might require only information on winning bids to be released and not require bidder identities to be disclosed.
- Bidding procedures should not provide participants with sensitive information regarding the actions of others tenders, but, conversely, should allow for review of decisions of public officials by independent public agencies.

# Choice of a bidding procedure, collusion and corruption

It is important that procurement officials are aware of the risks attached to certain bidding models.

If the **risk of collusion is limited** (because, for example, there are many potential suppliers) an **open tender** would be preferable.

If the **risk of collusion is significant**, then it would be preferable to use a **sealed-bid system**.

If the **risk of both collusion and corruption is significant**, procurement officials should still consider using a **sealed-bid tender, but make the tender “corruption proof” through the use of electronic or on-line bidding systems**, for example, could ensure that both the risks of collusion and corruption are limited.

# Co-operation between enforcement agencies

*Co-operation between the various national enforcement agencies with jurisdiction over collusion and corruption in public procurement is paramount, in order to achieve a coherent overall strategy and ensure its full implementation, and additionally, to facilitate efficient prosecution of these offences.*

# Co-operation between enforcement agencies

In certain jurisdictions, a single agency may have both a collusion and corruption remit, thus internalising this co-operation.

Whatever the structure of the co-operation mechanism utilised, it should, as basic principle, ensure:

- (i) **comprehensive coverage of all forms of malfeasance in public procurement; and**
- (ii) **efficient prosecution of any such offences that arise in practice.**

# **Example of cooperation between enforcement agencies: the case of Singapore**

Recognising that often collusion and corruption can occur together, the Competition Commission of Singapore (CCS) maintains close working relationships with the Corrupt Practices Investigation Bureau (CPIB), the agency which investigates and aims to prevent corruption in the public and private sectors in Singapore.

In particular, **the CCS has established a protocol with CPIB that addresses case allocation and administration between the two agencies and ensures clarity and efficiency in case management.**

# Exemple of cooperation between enforcement agencies: the Inter-Agency Bid Rigging Taskforce in Chile

In May 2008, the Competition Authority brought together several public bodies and an association of public procurement officials to set up a working group, known as the Inter-agency Bid Rigging Taskforce (Comité Anti-Colusión entre Oferentes en Licitaciones de Abastecimiento Público).

This team included representatives from the General Comptroller's Office, the public e-procurement authority (Dirección de Compras y Contratación Pública/ChileCompra), the Ministry of Public Works, the Auditor General's Office (Consejo de Auditoría Interna General de Gobierno) and REDABA (an association of procurement officials from different bodies). Representatives from the Department of Housing and Urban Planning, the Transport Regulator and the Pensions Regulator later joined the group.

# **Exemple of cooperation between a procurement agency and the competition authority: Mexico**

In 2006, the IMSS requested the CFC to analyze a set of bids because it had some concerns about the often high or similar prices presented by some bidders and the apparent low competition levels among them.

Following this request, the CFC opened an investigation against several pharmaceutical companies for possible anti-competitive practices in the public procurement processes of IMSS.

In January 2010, the six pharmaceutical companies involved were fined MXN 130 million (approximately USD 10 million), the maximum amount allowed at that time in Mexico.

# Improving the integrity of the public procurement process

*In addition to the existing framework of competition law, criminal justice legislation and public procurement regulations, a variety of more specialised mechanisms have been developed to protect and improve the integrity of the public procurement process.*

Such mechanisms include:

- Opening national markets to international competition.
- Redesign of the procurement process,

# **Improving the integrity of the public procurement process**

- E-procurement**, (but need to ensure that e-procurement procedures do not facilitate collusion, especially as this method eliminates the paper trail that might otherwise have provided evidence of bid rigging in the process).
- Certificates of Independent Bid Determination (CIBD)**, which require bidders to certify that they have arrived at their tender price absolutely independent of other bidders.
- Education of public officials, business and civil society**. This is perceived to be especially relevant in economies where rules against collusion and/or corruption in public tendering are relatively new or under-enforced.

# **Improving the integrity of the public procurement process**

- **Data analysis tools**, such as comparison of public databases to identify indicators of anti-competitive or corrupt activity.
- **Specialised review mechanisms for public contract awards**, whereby unsuccessful bidders who suspect flaws in the procurement procedure can challenge the award before a specialised tribunal.
- **Auditing of public procurement procedures**, whether conducted internally by a separate wing of the relevant public agency, or externally by an independent State body with specific powers of audit.

# Strategy to protect the integrity of public procurements

*The optimal strategy to tackle both collusion and corruption in public procurement requires a three-pronged approach: development of best practice rules for public procurement; extensive advocacy efforts; and vigorous enforcement action taken against any instances of corruption and/or collusion that are uncovered.*

# **OECD Guidelines for Fighting Bid Rigging in Public Procurement**

The purpose of the OECD Guidelines for Fighting Bid Rigging in Public Procurement (2009) is to help procurement officials to identify:

- Markets in which bid rigging is more likely to occur so that special precautions can be taken;
- Methods that maximise the number of bids;
- Best practices for tender specifications, requirements and award criteria;
- Procedures that inhibit communication among bidders;
- Suspicious pricing patterns, statements, documents and behaviour by firms, that procurement agents can use to detect bid rigging.

## Advocacy efforts

Advocacy efforts by competition authorities (and indeed by procurement agencies) can target private companies, particularly those who are frequently active in bidding markets.

- Adoption of internal procurement compliance programmes as a condition for bidding in a public procurement tender. Such compliance guidelines could be written in co-operation with or approved by the competition authority;
- Individuals who are responsible for bidding could be required to have attended regular briefings and programmes thereby encouraging knowledge of the penalties for collusion and corruption.

**Thank you very much**

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