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## **Global Forum on Competition**

### **COLLUSION AND CORRUPTION IN PUBLIC PROCUREMENT**

**Contribution from Mr. David Lewis**

-- Session V --

*This contribution is submitted by Mr. David Lewis (Gordon Institute of Business Science, South Africa) under session V of the Global Forum on Competition to be held on 18 and 19 February 2010.*

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## BID RIGGING AND IT'S INTERFACE WITH CORRUPTION

-- Contribution by Mr. David Lewis --

### Introduction: defining the terms

1. Bid rigging is a very large subject, the more so given its close interface with corruption. So it's as well to clarify at the outset the sense in which I will use the terms 'bid rigging' (or 'collusion') and 'bid corruption' (or 'corruption').

2. When I use the term 'bid rigging' I refer to a private agreement between competitors designed to determine the outcome of a putatively atomised, individualised bidding process. The agreement may cover price, market and/or customer allocation and the identity of the winner of the bid, and frequently also the payback to the losers. This is bid rigging in its normal antitrust meaning and which most competition statutes prohibit *per se* along with other price and market allocation agreements. Notionally competing suppliers are not competing on the merits, they are not offering the lowest priced, best quality goods and services that they are capable of supplying. They are rather putting in an offer that is the product of a clandestine agreements amongst themselves, an agreement that by its very nature will include not only the agreed, supra-competitive winning price but also the identity of the winner and, naturally, of the losers.

3. I distinguish this from 'bid corruption' which is the solicitation by, or offer to, a public official of something of value in order to influence the outcome of a bid. This is characteristically the province of the criminal justice system, although it may also be subject to sanction by the procurement authorities, that is, administrative bodies, who, in many jurisdictions, are empowered to disbar a firm from public procurement tenders, may sue for damages and void agreements.<sup>1</sup>

4. Although it is conceivable, and it undoubtedly does occur, that bid corruption may upset the best laid plans of colluding suppliers, I will focus on bid rigging (as defined above) and will consider bid corruption when it operates in tandem with bid rigging, when they complement each other. For reasons that are elaborated below this combination of bid collusion and bid corruption is particularly toxic.

5. I will not however deal with the interface between corruption and what may be termed 'exclusion' even though the competition implications and effects of the exclusion that arise from corruption are undoubtedly severe. This is the interface explicitly captured by the World Bank's broader definition of bid rigging whereby '*government officials manipulate the bidding process to exclude other (presumably cheaper) competitors.*' The fact is that, as the World Bank definition recognises, in relation to public procurement every act of corruption in the bidding process will always embody potentially grave competition implications even if the bid is not the outcome of a collusive agreement between competitors.

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<sup>1</sup> Note well that the World Bank, in its manual on the 'Most Common Red Flags of Fraud and Corruption in Procurement in Bank-Financed Projects', uses a much broader definition of bid rigging that explicitly takes in, is indeed principally directed at corruption. It defines bid rigging as a practice designed 'to ensure that the contract will be awarded to the bribe-paying firm (whose prices are now inflated to cover the costs of the bribe)' whereby 'government official manipulate the bidding process to exclude other (presumably cheaper) competitors.'

Firm A will pay a bribe to a state procurement official in order to secure a contract that A has chosen to contest, not on the merits, but rather by the payment of a bribe intended to persuade the buyer to reject the offering of A's rivals, no matter that their offering is superior. The upshot of 'pure' bid corruption (that is, bid corruption that involves no collusion) is that millions of consumers the world over are denied the benefits of the best quality, lowest price goods, which is precisely the objective of antitrust enforcement. However, in instances of bid corruption this has occurred because of the *corrupt* vertical relationship between a public procurement official and a producer of goods or services rather than as a result of *collusion* between horizontally related competitors.<sup>2</sup>

6. This Forum may want to consider whether there is, at competition law, an impeachable vertical agreement or even impeachable unilateral conduct arising from 'pure' bid corruption. As already intimated this poses the reverse of the usual vertical practice problem: consumer harm will not usually be difficult to identify and prove, but does the harm arise from an impeachable transgression of competition law? I will not deal with this issue although I will take note of exclusion where collusion and corruption interface precisely to extend an advantage to the cartel through the exclusion of a maverick or any other bidder who is not part of the cartel. Of course corruption may support a cartel in other ways as well, for example, in order to protect the cartel from detection, or to enhance the internal stability of the cartel. However when discussing the various interfaces between bid rigging and bid corruption I will occasionally draw on examples from 'pure' bid corruption cases. I will try, wherever possible, to illustrate issues in bid rigging, and, where appropriate, bid corruption by reference to actual cases.

7. But first a number of preliminary remarks. Firstly why '*collusion and corruption in public procurement*'. In particular is there a quality, a character, to collusion in public procurement that distinguishes it from any other form of collusion? Certainly the abiding character of public procurement is that it takes the form of the public issue by procurement authorities of tenders that specify the goods and services that are required by a public authority. Prospective sellers of the good or service in question then submit bids that offer to supply the specified products or services at a stated price. However, if there was to be collusion in the submission of these bids, how does this differ from any purchaser, public or private, approaching a range of widget manufacturers individually only to find that each offers, in consequence of a collusive relationship, an identical price and discount?

8. We should recognise at the outset that tenders issued by public procurement authorities cover anything from the supply of pens and pencils to government offices to the provision of a turnkey nuclear power station. That is, the variety of tenders will cover a range from the purchase of 'off the shelf' products whose specifications are easily established and described to immensely complex engineering projects or ICT products and services that require concomitantly detailed, complex and customised specifications. In the nature of things, by volume of tenders issued it will be the standardised products that dominate whether these be in the area of pharmaceutical products, building products or stationery products, although it is likely that the massive, highly specified armaments purchases or power stations or software systems loom larger when public procurement tenders are measured by value.

9. We should also recognise that, increasingly, procurement by means of tender is employed in the private sector as well. However this session of the forum is explicitly concerned with '*collusion and corruption in public procurement*'. Although, many competition statutes make specific reference to price fixing, market allocation *and* bid rigging in those sections dealing with the *per se* prohibition of particular types of horizontal agreement, suggesting that in the perception of many legislatures bid rigging represents collusion of a particular type, I know of no legislation that distinguishes the rigging of public tenders from

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<sup>2</sup> The bid corruption literature often refers to the vertical relationship between a procurement official and a bidder, as 'collusion' between buyer and seller.

the rigging of privately issued tenders. I will however focus on public procurement tenders although occasional reference will be made to private procurement tenders.

10. So what is special about ‘collusion and corruption in public procurement’?

### **Why bid rigging in public procurement?**

11. If hard-core cartel conduct is understood to be the most egregious antitrust offence, then bid rigging in public procurement is possibly the most egregious form of hard-core cartel conduct.

12. Firstly, as already intimated, it frequently operates in tandem with corruption thus drawing public servants into what is otherwise – that is, in characteristic price fixing or market allocation cartels – purely private conduct. Society is thus hit with a double whammy of criminality or law breaking - on the part of private sector players pursuing their private interests through collusion, and then by the extension of this criminality and self-interested conduct into the ranks of those public servants entrusted precisely with protecting the interests of the public. As we know while collusion is not always a criminal offence, it is generally prohibited *per se* in competition statutes. Corruption is, on the other hand, always a criminal offence.<sup>3</sup> I should emphasise that this is not to suggest that all collusive conduct in relation to public procurement necessarily involves corruption. As already intimated the intervention of corruption may upset a well organised cartel and make it more susceptible to detection. However, that there is frequently a relationship between corruption and collusion in tendering is sufficient to place it in a category of anti-competitive offences that demands particularly close attention.

13. Secondly, bid rigging hits the consumer with a double whammy. He not only suffers the characteristic consequences of hard core cartel conduct – higher priced products of inferior quality - but he pays an additional price because of the reduction it involves in the value of his tax dollar. He is, in other words, hit *qua* private consumer, and *qua* tax payer. He pays top dollar for an inferior good from a public agency which has used his tax dollars to purchase the inferior or over-priced product and then sell it back to him, say in the form of supra-competitive public transport fares or water charges.

14. Thirdly, we should recognise that most collusive conduct in relation to procurement by way of public tender is, in most of its essential aspects, indistinguishable from any of the other familiar forms that collusion takes insofar as its essential mechanisms involve the fixing of a price and the allocation of a market. Because the form that the purchase takes is that of a public tender, it presupposes that the colluding firms agree which firms will participate in the tender, will bid for the contract (market allocation), and the minimum price or maximum discount (price fixing) that will be tendered by those firms who are designated as the losers of the bid, in order to ensure that the pre-determined winner, does indeed triumph. Hence, when all is said and done for the most part the rigging of a bid in response to a public tender is concerned with familiar questions of price fixing and market allocation.

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<sup>3</sup> At least this is true of the recipient of the bribe. Regrettably it is not always true of the bribing party. Notoriously, until recently in several European countries bribes were tax deductible expenses, at least if paid to foreign government officials.

### Box 1. The South African Cement Products Cartel

This is one of the most comprehensive, longest standing cartels yet uncovered in South Africa. The cartelised products included pre-cast concrete pipes, culverts and manholes with a variety of applications including road building and maintenance, the construction of storm water systems and water reticulation infrastructure and sewage systems. The vast majority of the products were procured by public tender either by the public sector itself or by firms under contract to the public sector. The cartel leaders were both South African based – Rocla a subsidiary of the giant Murray and Roberts Group and Infraset a division of the Aveng group – and are sub-Saharan Africa’s leading suppliers of cement products. Rocla applied for and was granted leniency and the Commission filed charges against 10 other companies, several of whom, including Infraset, have entered into consent decrees with the Commission.

The modus operandi of this cartel, which operated for 35 years and which covered the South African, Swaziland, Botswana, Namibia, Zimbabwe, Mozambique, Zambia and Tanzanian markets was the fixing of prices and the allocation of contracts and tenders in accordance with agreed upon market shares in designated regions. The allocation occurred at monthly meetings with a cartel member known as ‘the banker’ responsible for allocating contracts and receiving reports from each of the members regarding tonnages sold in a designated period. Where the tonnages sold had the effect of distorting the agreed market shares, the banker would ensure that this distortion was corrected by subsequent allocations.

Thus, although the form of much of this cartel activity involved ‘bid rigging’ it was, for the most part, a plain vanilla price fixing and market allocation cartel that measured its success in its ability to maintain agreed market shares. However the mode of price fixing had to be geared towards competing for a bid. Accordingly, for each bid – in which the appearance of competition had to be maintained – each bidder was assigned a maximum discount off the transparent list prices, with the designated winner naturally permitted the largest discount and with the rest, the designated losers, submitting ‘cover prices’, prices which by virtue of the lower discount permitted by the cartel, exceeded the price quoted by the designated winner. In particular contracts, the compensation to the losers, generally in the form of a share of the contract, was also agreed.

It was a minutely detailed, comprehensively planned operation dependent upon significant flows of information. While the cartel undoubtedly wrought major damage in key markets there was no evidence of corruption revealed to the Commission, although it is important to add that corruption is not the Commission’s remit and this is not what it was looking for.

15. However, notwithstanding the essentially familiar aspects of most instances of bid rigging, the sheer scale of public sector procurement and the overwhelmingly prevalent use of public tenders as the form of procurement alone makes it worthy of particular attention. Indeed, it is, usually mandatory for the public sector to procure by way of public tender in respect of any purchase above specified thresholds. It is also a requirement of large lending agencies that provide project financing such as the World Bank, funding which is generally made through a government agency. And of course procurement by the public sector represents a very high proportion of GDP, estimated to be as high as 15% in OECD countries and certainly higher in many developing countries.

16. Public procurement is thus particularly vulnerable to corruption, collusion, fraud of various types and embezzlement because of the large amounts of money characteristically involved and the difficulties of supervising a large number and wide range of projects. As already noted, increasingly there are large public tenders put out by private procurers of goods and services. However, and this generalisation naturally does not hold good in all instances, the in-house skills and expertise involved in the evaluation and adjudication of a complex tender are probably more readily available in the private sector than in the public sector procurement office, if for no reason other than that the latter has to spread its monitoring and other resources over a greater number and variety of projects or has to rely on the services of outside consultants – that is to say the information asymmetries between the buyers and sellers in a public sector procurement tender are bound to be greater than in a private sector procurement tender and the detection

capabilities concomitantly smaller and more thinly stretched.<sup>4</sup> And, while public sector procurement contracts are generally shrouded in more elaborate arrangements to protect against corruption and collusion, regrettably the profit maximising incentives in private procurement are probably greater than the incentives to efficiently utilise tax payer funds. Indeed it is largely because of the absence of a direct incentive to spend tax dollars as efficiently as private dollars that bidding is so ubiquitously employed in public procurement and is subject to such elaborate administrative rules.

17. Bid rigging is of course particularly damaging when a country is engaged in exceptionally large infrastructural spend programmes, whether for a particular event – for example, the hosting of the FIFA World Cup – or where a government is, again as in **South Africa**, employing infrastructural spending as the major component of an economic stimulus package and as a necessary foundation for long term growth. The South African Competition Commission has explicitly identified bid rigging in construction and construction-related sectors as a strategic focus of its enforcement activities precisely in order to align itself with government’s infrastructure build programme. The data pertaining to the leniency applications received by the South African Competition Commission is detailed in its submission to this forum. Suffice to say that the vast majority emanate from the construction sector and many admit to collusion in the preparation and submission of bids in response to public procurement tenders.

18. The submission of the **United States** outlines an initiative of the Antitrust Division aimed at preparing government officials and contractors to recognise and report efforts by parties to unlawfully profit from stimulus projects that are being awarded as part of The American Recovery and Reinvestment Act of 2009.

19. Fourthly, and following from this, there is a particularly offensive aspect to the wilful perversion of a mode of procurement that is ubiquitously employed in the public sector precisely in order to secure competition and public accountability. The practices of bid rigging and bid corruption do not ‘merely’ ensure the provision of inferior goods at supra-competitive prices, it seriously undermines a key component of sound, accountable public governance.

20. Moreover, the impact of public procurement bid rigging on poor consumers is disproportionately great. In fact while in an effectively operating progressive tax system the rigging of public procurement tenders may hit the rich *qua* tax payer proportionally more than it hits the poor *qua* tax payer, *qua* consumer it is inevitably the *poorest* consumers who pay the highest price for bid rigging. It is those who use *public* education facilities, *public* hospitals, *public* transport, *public* housing that pay directly for the increment in price or the lowering of quality that is the consequence of rigging a public sector procurement tender.

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<sup>4</sup> The bid corruption literature deals extensively with the problem of corruption in the procuring of consultants acting as advisers on public sector procurement, particularly when this gives them a key role in preparing the tender and in evaluating the responses.

Box 2. Bid rigging in Health Care markets – South Africa, Turkey and Romania

In the **South African** case of *The Competition Commission vs Adcock Ingram Critical Care (AICC) and four others*, it was established that five pharmaceutical companies had, over a period of at least fourteen years, colluded in rigging bids for the supply of intravenous solutions to the public hospitals, a tender initially issued annually and later every two years. Prices were fixed, markets worth many hundreds of millions of rands were allocated and winners and losers were determined, as was the compensation, often in the form of a post-award sub-contract, for the losers. In a statement submitted to the hearing at which the Tribunal approved the consent decree, a representative of the national Department of Health succinctly summed up the character of bid rigging and the nature of the problems that it posed:

*The Department of Health purchases large volume parenterals and administration sets through the public tender system in order to secure affordable prices, which ultimately benefit the many people who use the public health system, and as has been stated, the majority of whom are poor. The advantages for the suppliers are a guaranteed market, economies of scale and a binding contract...*

*We are committed to giving preference to local manufacturers to promote job creation, poverty eradication and skills development. However, it is difficult to pursue these objectives of promoting local manufacture when such manufacturers act in such a manner. We find it very disturbing that SMMEs that get preferential points in the tender system to enable them to gain market share, resort to this kind of behaviour...*

*These findings beg the question of whether this is the only case of collusion in the industry and there is a high possibility that this is not the only case of collusion in the industry. The challenge that we face is how does one prevent such collusive practices in the future? Tender systems, by their very nature, are at risk of collusion, especially in the pharmaceutical sector where there are usually only a handful of competitors that are known to one another.*

Note that **Turkey's submission** to this roundtable reveals that in 2009 most of the bid rigging investigations carried out by the TCA were in the health sector, including medicines, laboratory supplies and medical equipment. This appears to have included the prosecution of several cases of collusive boycotts of tenders issued by procurement authorities in the health sector. As with the South African public health official cited here, the Turkish submission ascribes the frequency of bid rigging in health markets to the oligopolistic structure of the suppliers' markets. In 237 out of 310 tenders issued in Turkey for laboratory equipment fewer than 3 suppliers responded to the tenders.

**Romania's submission** also identifies the health sector as the sector most vulnerable to bid-rigging practices. Thus, in 2008, the RCC imposed fines totalling approximately Euro 22.6 million on four pharmaceutical companies for sharing the publicly funded section of the insulin market in the context of a national tender organised in 2003 by the Ministry of Health. The collusive practice in this case aimed at sharing the diabetes product portfolio of a drug manufacturer between 3 distributors.

In another important case, 3 distributors who rigged a bid in response to a national tender issued by the Ministry of Health for the supply of dialysis products and equipment were fined Euro 1,5 million.

The **Romanian submission** raises many other examples of dubious tendering and bidding practices in various markets for health products. Many of these appear to relate to the preparation of exclusionary tender specifications.

21. Fifthly, given the scale and concentrated nature of public procurement by way of tender, it is potentially easier for the competition authorities to enlist the purchasers as allies in identifying and apprehending collusive conduct than is the case in markets characterised by more fragmented, atomised purchasers. For example, it is striking that while the South African health department's procurement authorities in the South African *Adcock Ingram* matter (see the box above) were aware of the practice of post-award sub-contracting to the losers, this never seemed to have aroused their suspicions although the practice is a textbook red light signalling collusive conduct. However, the good news of course is that the prospect of teaching and enabling a procurement committee to recognise cartel conduct is significantly greater than the prospect of achieving the same level of awareness amongst thousands of individual consumers. I will return to this issue below.

22. Moreover, when purchasing is concentrated in the form of a small number of large bids it is significantly easier to measure the actual extent of consumer harm and seek recompense than in the case of thousands of atomised consumers. In *Adcock Ingram* evidence unearthed by the Commission documents quite precisely the increment in price achieved by the bid rigging cartel in each successive tender. The estimates – partly demonstrated by what occurred when, in one tender, one of the cartel members reneged on the agreement necessitating the last minute submission of a new price by other members – vary from increments over a notional competitive price ranging from 10% to 33%, increases compounded by each successive rigged bid. Turkey’s submission cites its Ministry of Construction who is quoted in an OECD study: “[u]ntil the enactment of the new Public Procurement Law in 2003, Turkey has suffered exceptionally high construction costs by international comparison. For instance, the cost of construction for 1 km of highway was US\$ 10 million in Turkey, compared to international reference price of a US\$ 4 million “

23. One final point here: while, as illustrated by the *Rocla* case (see box), the fact that public procurement takes place by way of public tender does not distinguish its essential mechanisms from the price fixing and market allocation that is at the heart of most hard-core cartel conduct, cartelisation of the bidding process in true bidding markets – for example, the tendering for the building of a massive power station, a one-off project which cannot be bought off the shelf using transparent price lists and in which the winner may take all – may become immensely complex precisely because of the scale of the contract and the fact that it is unlikely to be repeated in the foreseeable future means that it may lead to massive ‘disturbance’ in the market. That is, these contracts have the capacity to disturb precisely what bid rigging, or any other form of cartel, is aimed at preserving: the stability of market shares. These are the circumstances in which the principal contractor may be required to organise a complex array of consortia and sub-contracts, precisely to ensure that a carefully organised cartel, or even series of cartels, is not disturbed by a contract of the sort described that may be characterised as part of the unusual genus of bidding market.

### **Bid Rigging and Bid Corruption**

24. However, let’s return to the interface between bid rigging and corruption. As already noted, a corrupted tendering process does not presuppose that there has also been collusive co-operation between the bidders. Quite the contrary, it will, more often than not, reflect an exclusive relationship between the corrupted officials and a single seller who has secured a place at the head of the queue through an act of corruption – drawing on family connections, or powerful political connections, or simply the payment of a bribe. In this instance, the bid is corrupted but not collusive. However, even in a non-collusive, but corrupted, bid the co-operation of the losers may well be necessary lest the corrupted pre-arranged outcome is upset by disgruntled and uniquely well-informed losers thus necessitating a degree of agreement between the private bidders. Once this happens, once other potential bidders are drawn into the corrupt conspiracy between a procurement official and a potential supplier, it would appear that – although this warrants further discussion – the loser who accepts a kickback for accepting the outcome has both abetted corruption and entered into a collusive arrangement.

25. By the same token, collusive bid rigging does not necessarily involve corruption, that is to say, it does not necessarily pre-suppose that the colluding bidders are in a corrupt relationship with the public officials responsible for the preparation and/or adjudication of the bid. Indeed, as already intimated, it is not difficult to imagine how the intervention of a corrupt official may disturb a well organised cartel such as the cement products cartel outlined above.

26. However, it’s reasonable to hypothesise that bid rigging and bid corruption will frequently work in tandem. Certainly there are powerful incentives to bolster bid rigging with bid corruption. Corrupt procurement officials may be of service to a bid rigging cartel in numerous ways. They may provide

advance notice of a bid and consult the cartel organiser in the preparation of the tender specifications. This is a particularly valuable function insofar as it can be used to secure conditions favourable to cartel formation by excluding, through purposefully designed tender specifications, mavericks or non-cartel members from eligibility for the bid. In general, given that those who are managing the bid have a large measure of discretion in deciding which bidders have qualified, corrupted public officials may exercise this discretion to disqualify non-members of the cartel from the bidding process on spurious grounds. This act of corruption reduces the number of bidders and the obstacles to cartel formation and the prospect of detection. **Pakistan** cites the considerable discretion given to procurement authorities in determining the responsiveness of the bid – that is, the bids compliance with the baseline conditions for validating the bid – as a major source of both corruption and bid rigging. **El Salvador** reports that its competition authority examines public procurement from two perspectives, namely, in order to detect evidence of bid rigging and to determine whether the terms of the bid designed by a public contractor reduce or limit competition in the bid procedure.

### Box 3. Fuel procurement in Zambia and tractor procurement in Pakistan

A recent fuel tender in **Zambia**, although apparently in favour of a single preferred buyer rather than a cartel, is an instructive example of the pertinence of influence at the bid preparation stage. Here, in a two year contract to procure crude oil worth some US\$1.4bn – a very significant act of public procurement anywhere and more so in an economy of Zambia's size – it is alleged that senior government officials directed the Zambian Public Procurement Authority to design tender specifications to accommodate a pre-selected bidder. The media, quoting an unidentified source, charges that the changes that were made to the original tender document required that '(1) bidders must own or charter in excess of 30 oil tankers at any given time; (2) the bidders must own or operate a refinery capacity in excess of 1 million barrels per day; (3) bidders must produce crude oil in excess of 1 million barrels per day and (4) bidders must trade in excess of 2 million of (sic) crude oil per month'. And then, in what appears to be ultimate act of exclusion, lest all others fail, the bidding was to close on the 18th December 2009 and the first delivery of crude oil was scheduled for a fortnight later, on the 1st January 2010! After the Zambian Competition Commission referred the matter to the Anti-corruption Commission, the tender was withdrawn and redesigned.

The Competition Commission of **Pakistan** effectively utilised its advocacy function in improving procurement practices in a Tractors Subsidy Scheme (2008-09) launched by the Government of Punjab. The CCP received complaints from a number of manufacturers and importers of tractors who claimed that only two local tractor manufacturers had been invited by the Agriculture Department of the Government of Punjab to supply tractors under the Scheme. The CCP took cognisance of this apparent exclusion of all other manufacturers, dealers/importers of tractors and informed the concerned authorities of the provincial Government that this action ran afoul of competition principles. The situation was rectified and the provincial Government started negotiations with rest of the manufacturers and importers of the tractors for the supply of tractors under the Scheme.

27. Another large **South African** bid rigging cartel – in this instance a purchasing cartel - appears to have benefitted from the assistance of, as the cartel leader put it in an email exchange with other members of the cartel, 'our boys' in the procurement authority of a large state owned enterprise. Here, it appears that the assistance took the form of advance information about sales of the product in question and inside information on the pricing expectations and strategies of the sellers.

28. Recently, much media attention has been given to a large tender put out by a large South African publicly owned utility, where a contract is alleged to have been awarded on the basis of a closed tender, that is a tender for which selected firms are invited to bid, rather than an open tender as apparently required by the pertinent tender rules. A senior executive is alleged to have authorised the use of a closed tender system without possessing the requisite authority to override the standard operating procedures applied to

tenders of this scale.<sup>5</sup> Note that the allegation here is not one of collusion – although that may yet surface. Rather it is that the purchaser assisted a particular bidder by utilising a tendering procedure that excluded potential competitors.

### **What is to be done about bid rigging and bid corruption?**

29. We have seen the anxiety expressed by the South African health department official in relation to the rigging of pharmaceutical bids. It is not misplaced. Bid rigging in public service tenders, and particularly in civil engineering and construction, appears to be such a widespread and deeply entrenched practice that one is entitled to despair at it ever being eliminated or significantly reduced.

30. However, the costs are so great that it justifies moving bid rigging and bid corruption to the top of the agenda for both competition enforcement authorities as well as for the authorities charged with policing corruption. The World Bank estimates that public procurement bid rigging inflates price by 20-40 per cent. Some evidence of the cost of bid rigging has been gleaned from the submissions to this roundtable and are reported above. Suffice to say that all estimates of the premium charged as a result of bid rigging in public procurement significantly exceed the rule of thumb estimate of a 10% premium which is widely accepted as the premium resulting from ‘ordinary’ price collusion. Indeed it is not surprising that price inflation in rigged bids would be higher than in other collusive activity because the winning firm has not only to ensure the monopoly rent that is the point of the collusion in the first place, but it must ensure a premium sufficient to enable the losers to be paid off and, in many instances, to enable the bribed public officials to receive their agreed pay back.

31. It is equally clear that bid corruption is commonplace. Moreover it appears that some of the most effective strategies available to defeat corruption are used in the formation and maintenance of cartels. Maximum transparency is generally considered to be a powerful antidote to corruption but it equally provides an important source of the information necessary to form cartels and to detect cheating. I recall responding to a bid put out by USAID for a research contract in which a specific opportunity was given to each of the qualifying bidders to pose questions to USAID aimed at clarifying aspects of the bid. The questions had to be posted on a website to which all the other bidders had access, as were the answers. The objective was clear: it was to ensure that no bidder was able to engage in *ex parte* communication with the purchaser of the service that may have enabled the passing of selective information and provided even the appearance of possible corruption.<sup>6</sup> However, the opportunities that this creates for collusion are manifest and this practice, alongside joint site visits and the like, is not uncommon particularly in the context of large and complex engineering or ICT tenders where bidders understandably are often obliged to pose clarificatory questions and request additional information before submitting a bid. It is striking how many of the competition authorities who have made submissions to this forum advocate transparency as a mechanism to limit bid corruption without apparently appreciating the support that it may give to bid collusion.

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<sup>5</sup> It appears from **Turkey’s** submission that there the Public Procurement Act specifies that open tenders are the default form in which public tenders must be issued. Other forms of tendering can only be practiced when specified special conditions for their use are present. In **Singapore** open tendering is also the default option. Selective tenders limit suppliers who satisfy the conditions for participation on grounds such as financial solvency, experience and capability but limited tendering may only be used in exceptional circumstances.

<sup>6</sup> I may give USAID more credit than it deserves. The purpose may simply have been convenience – to preempt having to answer the same question several times over – but I don’t believe this to be the case. I understood the requirement to be aimed at promoting transparency.

32. The anti-corruption community is, as is to be expected, unanimously committed to transparency as the key weapon in the fight against corruption, including in corrupt procurement practices. However, although the quantity and character of information that anti-corruption watchdogs demand be made transparently available may cause concern to the anti-collusion watchdogs, there is no doubt that certain of the data gathered may greatly assist in the detection of collusion. For example, in the area of procurement of anti-retroviral drugs used to combat HIV/AIDS, researchers from Boston University working with the UK's DFID have developed a 'high price outlier analysis' where the 'high price outliers' are precisely likely to indicate collusion rather than corruption. Interestingly while the researchers concede that these outliers may be the consequence of 'managerial difficulties' rather than corruption, they do not seem to have contemplated the possibility of horizontal collusion.<sup>7</sup>

33. By the same token measures to counter bid rigging may facilitate and incentivise bid corruption. For example, a regular pattern of tendering public service contracts, as opposed to less frequent, large contracts, may facilitate collusion because it brings suppliers into more regular contact with each and it more easily enables the sharing out of contracts between the members of the cartel thus promoting the stability of the cartel. Moreover, a large contract, as opposed to a number of smaller contracts, is also more likely to attract bidders from outside of the geographical area, including international bidders.<sup>8</sup> The antitrust authority may thus urge less frequent, larger tenders upon the public procurement office in order to avoid a pattern of bidding that facilitates collusion.<sup>9</sup> However, large contracts may incentivise the paying of bribes, lower the cost of bribing (because there is only one set of procurement officials to bribe instead of several) and reduce the possibility of detection because fewer people will have knowledge of the payment of the bribe than would be the case where multiple bids had to be corrupted.

*So what is to be done?*

34. Close co-operation between the competition authorities and those responsible for policing corruption is essential. While it is obviously not known with any precision what proportion of collusive bids also involve corruption, the incentives for these practices to operate together are sufficiently strong to justify the competition authorities and the anti-corruption authorities to proceed on this basis. However, gauging the response of several sub-Saharan African countries to public procurement bid rigging, while it is clear that there is a ready inference drawn that a rigged bid has enjoyed inside support, that it operates in tandem with corruption, it appears common practice for many competition authorities who are alerted to bid rigging elect to simply hand over the cases to the public procurement or anti-corruption officials. One senior African competition official explained that the latter – the anti-corruption officials – enjoyed greater investigatory powers and resources than the competition authorities and are empowered to impose

<sup>7</sup> See Brenda Waning and Taryn Vian - *Transparency and accountability in an electronic era: the case of pharmaceutical procurements* published on the website of U4 Anti-Corruption Resource Centre ([www.U4.no](http://www.U4.no)) The U4 website is a gold mine of information in the area of corruption. It is however striking how little the site mentions collusion. When it does mention 'collusion' it usually refers to the vertical relationship between a procurement official and a bidder.

<sup>8</sup> This paper does not deal with the interface between international trade and public procurement. This is dealt with in detail in an excellent paper by Rob Anderson of the WTO and Bill Kovacic of the US FTC which has been made available to participants in this forum. (see Robert D. Anderson and William E. Kovacic *Competition Policy and International Trade Liberalisation: essential complements to ensure good performance in public procurement markets* Public Procurement Law Review (2009).

<sup>9</sup> The submission from the **United States** notes: '*Antitrust agency officials provide advice about techniques that procurement officials can use to make it less likely that their programme will become the victim of a bid-rigging scheme. For example, in certain circumstances DOJ attorneys have advised procurement officials to combine work into larger contracts so that competitors outside the local geographic area will decide that it is profitable to bid on the contracts, resulting in more competition for each contract.*'

significantly greater sanctions. It is also likely that the anti-corruption culture is stronger than the pro-competition culture and so public appetite and support for the investigation of corruption is greater than in the case of competition violations. Moreover, the estimates of the sheer scale of corruption in public procurement are so vast that this factor alone may explain a focus on bid corruption over bid rigging. The submission by **Pakistan** cites an estimate by Transparency International that puts kickbacks in public procurement contracts at about 25% of the procurement or project budget. The World Bank is reported to have estimated the cost of corruption in public procurement alone at 15% of Pakistan's development budget for 2007/8.<sup>10</sup>

35. The evidence and the incentives tell us that corruption may be sufficiently useful to a bid rigging cartel that, as a matter of course, the competition authorities should always invite the anti-corruption officials to investigate possible corruption in a bid rigging cartel. By the same token, the anti-corruption officials should invite the competition authorities to explore a possible collusion angle in any case of bid corruption.

36. In **South Africa** the Competition Commission and the Special Investigating Unit (SIU), an independent branch of the criminal justice system responsible for policing corruption, agree that the most effective instrument for reducing bid rigging and bid corruption is robust enforcement. This has certainly reaped a rich harvest for the Commission. The data on leniency applications is cited in the Commission's submissions as is the extent of bid rigging involved in these applications, notably, although by no means exclusively, in the construction and related sectors. The flood of leniency applications is doubtlessly a product of the Commission's strong enforcement record as well as the imminent criminalisation of collusion, including bid rigging.

37. The SIU has also engaged in some very high profile investigations, most notably alleged bid corruption in the awarding of multi-billion rand tenders by the Department of Correctional Services. It is exploring the introduction of a plea bargaining arrangement along the lines of the Competition Commission's leniency programme.

38. In addition the South African Competition Commission has, in close co-operation with the National Treasury, engaged in an extensive programme aimed at assisting the various national, provincial and para-statal procurement authorities in identifying collusion. The contents of the programme are similar to those conducted by many other authorities. Hence the South African Commission's presentation to the procurement officials identifies the various forms that bid rigging traditionally takes. These include complementary bidding or cover bidding, bid suppression where bidders either withdraw a submitted bid or fail to bid at all, bid rotation whereby the bidders take turns in winning a series of tenders, sub-contracting or other forms of compensation to losing bidders or joint venture bidding. It has also identified a number of red lights that may indicate collusion in the bidding process. These include the same winning bidder for particular work, or where the same suppliers bid but take turns in winning, or bids received at the same time with similar prices and cost calculation. Other red lights include the failure on the part of an obviously qualified firm to bid on a lucrative contract, a sudden drop in the bid price upon the entry of a new or infrequent bidder, sub-contracting to a loser and suspiciously high bids without logical underlying cost differences. Bid rigging is also indicated by such prosaic features as common handwriting or fonts or common spelling errors. Sequential numbers on banking securities will indicate that a single person has gone to arrange the securities for a group of bidders.

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<sup>10</sup> An impressionistic reading of the submissions to this forum would indicate that while anti-corruption and/or procurement authorities frequently have jurisdiction over collusive bid rigging, competition authorities never have jurisdiction over bid corruption, despite the anti-competitive implications of the latter. Nor is this surprising. It almost certainly results from the highly specialised nature of competition jurisdiction and the absence of criminal sanction in many national competition statutes.

#### Box 4. A costly typographical error

The United States submission reports a case where a combination of a simple typographical error and alert procurement officials led to a successful bid-rigging prosecution: *‘Two companies submitted bids for the repair of certain government equipment damaged by a storm. Each company submitted a cover letter with its bid expressing its interest in performing the work. A procurement official noticed that each cover letter contained the same typographical error (an unnecessary word), which was as follows: “Please give us a call us if you have any question.” The procurement official was concerned that the companies had colluded on their bids and he reported his concerns to the Antitrust Division. Following a full investigation, the companies and individuals involved were prosecuted and convicted for bid rigging and other violations.’*

39. The South African Competition Commission’s programme also suggests mechanisms for mitigating bid rigging. These include taking particular care in the design of the procurement process, while avoiding imposing a requirement to bid, nevertheless seeking an explanation for a failure to bid, and maintaining extensive and detailed records that will enable the detection of suspicious bidding patterns. The Commission has also proposed to the National Treasury that the submission of certificates of independent bids be made mandatory.

40. The Commission has also produced a booklet drawing heavily on the OECD Guidelines for Fighting Bid Rigging that is aimed at assisting procurement officials in the identification and mitigation of bid rigging. Most of the submissions report the publication of manuals that are prepared by the national competition authority aimed at assisting public procurement officials to detect bid rigging followed up by training courses to this end.<sup>11</sup>

#### Box 5. US bid rigging training and outreach programmes

The US submission outlines the DOJ’s extremely comprehensive training and outreach programmes to combat bid rigging. It reports considerable success in combating bid rigging which it attributes, in significant part, to the impact of its training and outreach programmes. It suggests that a comprehensive training programme should:

- Explain the legal standard for a violation
- Explain how antitrust investigations are conducted
- Discuss penalties for bid-rigging and other antitrust violations
- Discuss indicators of bid-rigging
- Encourage procurement officials to report anything suspicious
- Give examples of matters in which procurement officials have played a key role in the detection of bid-rigging
- Discuss other crimes that may be prosecuted, including a variety of corrupt and fraudulent practices

41. Data collection and collation is a critical factor in combating bid rigging and bid corruption. We have noted the firm commitment of the anti-corruption community to transparency and the potential dangers that this portends for cartel formation. However, it is clear that transparency is so potentially effective in countering corruption that it will overcome any objection to the effect that it may support bid collusion. But effective information and data will also support efforts at countering bid collusion. I have

<sup>11</sup> See, inter alia, submission by **El Salvador**. The submission by **Brazil** reports a particularly energetic advocacy and education campaign around bid rigging.

already made mention of the ‘price outlier’ analysis used in combating corruption in the procurement of ARVs. It appears that the best path for competition enforcers is to engage with the anti-corruption community in identifying data that will be useful to fighting both corruption and collusion, and, concomitantly, identify those that, that if made publicly available, may abet collusion.

42. The submission from **Singapore** recognises that the additional transparency promoted by its e-procurement web portal may facilitate collusion. However it argues that:

*..these risks are alleviated to a certain extent by the structure of the tender system itself. GeBIZ as a web portal allows for the maximisation of potential participation of competing bidders worldwide; it encourages both local and foreign participation in procurement, reduces the costs of bidding and put in place participation requirements that do not unreasonably limit competition and thereby reduces the possibility of collusion. Further, the government allows smaller firms to form a consortium and tender for bigger projects to allow more firms, including small and medium enterprises to participate in such tenders. Transparency on prices also allows benchmarking across firms and therefore facilitates competitive bidding. Moreover, the easy availability and access to information via an electronic forum by which tender and award information is provided allows for ease of monitoring and policing by the authorities. Competitors can request for information on tender selection to review evaluation results and competition authorities can detect bid rigging activities via analysis of bid history patterns and other bid data.*

**Box 6. Data Gathering:  
Korea's Bid Rigging Indicator Analysis System (BRIAS), Brazil's Public Spending Observatory (OPD)  
and South Africa's Special Investigating Unit**

**Korea** utilises data gathering and coordination in a systematic effort to detect bid rigging. Its Bid Rigging Indicator Analysis System analyses bid-rigging indicators based on data concerning bids placed by public institutions. With the data delivered online from the public institutions, the analysis system calculates the probability of bid rigging by giving weightings to various indicators like bid-winning probability, the number of bidders, bid prices, competition methods, the number of unsuccessful bids and hikes in reserve prices, transition into private contracts, etc.

Since October 1997, the KFTC has undertaken manual analyses of bidding documents obtained from some public agencies, and then in September 2006 it set up the analysis system for bid-rigging monitoring. At first, it was applied to information provided by Public Procurement Service, but the Commission has gradually expanded the application of the system until in 2008 it was mandatory for all public bodies engaged in procurement to provide information for the BRIAS. From January 2009, the KFTC has secured the legal powers ground in the MRFTA for mandating all the public bodies to provide it with bid-related information for analysis by BRIAS.

The analysis system helps the KFTC better uncover bid rigging conspiracy by enabling it to monitor tenders of the public sector chronologically and conduct on-site investigation into those with significant indication of bid rigging. It also prevents national budget waste caused by bid rigging and helps establish a fair competitive order. Furthermore, the system makes companies voluntarily stay away from bid rigging by sending a signal that the KFTC is keeping an eye on every bid for public work.

In **Brazil**, the Office of the Comptroller-General (CGU), the federal agency responsible to the President for all matters related to the defence of public assets and transparency in administration, has established the Public Spending Observatory (OPD). The OPD is a permanent intelligence unit combining the practical knowledge and experience of auditors with advanced IT tools that enable the auditors to speedily process enormous volumes of data from hitherto disparate sources. This IT based consolidation and collation transforms the utility of previously disaggregated data in the identification, prosecution and prevention of corruption, fraud and collusion in public procurement. Hence the tax administration system provides information about the corporate structure of bidding companies and its partners, while family relationships are revealed by the social security service data bases and multiple data bases register addresses.

**Box 6. (Cont.)**

Crossing these data, the OPD identifies 'trails' and patterns that require further investigation. For example, the participation of companies with common shareholders in the same procurement procedures, different bidders with the same address, family bonds and past and present employer-employee relationship between partners and directors of the bidder companies. Internal analysis of the procurement databases may also indicate suspicious patterns of bid-rotation and market division among competitors by sector, geographic area or time, which might indicate that bidders are acting in a collusive scheme. Those "trails" are automatically followed on a daily basis, resulting in "red" or "orange" warnings to the administrative or criminal authorities or even to the federal agency responsible for the problematic procurement process. Once a suspicious pattern is detected, it is loaded in an OLAP (Online Analytical Processing) tool which results in reports and management review panels. The main objective is to analyse the distribution of bidding processes of a product or service by geographic area, government agency, amount of resources involved, per year during a certain period of time.

**South Africa's** Special Investigating Unit has also embarked on the difficult but potentially fruitful task of enabling various pertinent data bases to speak to each other. For example, data from procurement agencies may reveal patterns that indicate bid corruption which, if aligned with the data base maintained by the companies registration office may reveal the existence of shell companies or a pattern of inter-locking directorships between the bidding companies. If aligned with the data banks of the Department of Home Affairs, familial relationships between procurement officials and the directors of bidding companies may be revealed

43. Without exception, the submissions to this roundtable recognise the necessity for intra-governmental co-operation. A central part of the South African government's response to the ramifications of the global economic crisis is the establishment of a high level task team to 'effect savings'. The task team comprises the Ministers of Finance and Public Service and Administration and the Minister in the Presidency responsible for Performance Monitoring and Evaluation. '*Combating wastage, leakage and corruption in government, specifically in the procurement system*' is explicitly identified as a key aspect of government's efforts to effect savings, although collusion in the tendering process is not mentioned, despite anti-competitive procurement practices – such as preferences accorded certain state owned entities – being explicitly viewed as significant factors raising the costs of procurement. In order to tackle fraud and corruption a task team reporting to the Minister of Finance comprising the National Treasury, the Revenue Services, the Financial Intelligence Centre, the Special Investigative Unit and the Auditor General has been established with a range of enhanced enforcement sanctions and investigative resources under close consideration. As of the time of writing the Competition Commission is not represented on that committee although given the close relationship between collusion and corruption it is a clear candidate for membership.

44. The Special Investigative Unit and the Competition Commission are both committed to engaging with each other. As noted earlier while it is possible that the most commonly utilised mechanisms to counter bid rigging and bid corruption may sometimes work against each other, the obvious cure of this is close liaison between the agencies responsible for policing and prosecuting these closely related phenomena.

**Conclusion**

45. While bid rigging frequently utilises precisely the same mechanisms as 'ordinary' price fixing and market allocation cartels, there are good reasons for competition authorities to maintain a particular focus on cartelisation in the area of public procurement. In particular it is the ubiquitous, if not always necessary, relationship with corruption that warrants particularly close attention.

46. The relationship between corruption and collusion in public procurement immediately suggests the benefits of close co-operation between the agencies responsible for the prosecution of each offence.

This has been advocated – and is often practiced – by many of the participants in this forum. In addition training procurement officials to recognise rigged bids is widely supported as is the more difficult task of ensuring that various data bases ‘speak’ to each other, the better to act as warnings of bid rigging and bid corruption. A particularly valuable product of co-operation may be the exchange of data and the design of data collection systems that do not, in the name of transparency, promote collusion.

47. It is imperative that the competition authorities and those directly responsible for fighting corruption remain cognisant of the tremendous cost that these offences impose on society and it is equally imperative that this be communicated to the public. The costs are not ‘merely’ micro costs imposed on selected consumers or tax payers. They are generally imposed upon the poorest consumers of the most basic products and they embody potentially powerful macro-implications.

48. The Economist (9<sup>th</sup> January 2010) recently noted:

*As leader of Italy’s socialists from 1976 to 1993, Craxi was among the orchestrators of a system in which the main parties, and their officials, fed off bribes from companies bidding for public contracts. The cost of those kickbacks was routinely added to the price of the work, so this system contributed to the huge public debt under which Italians and their governments now labour (my emphasis).*

49. Of course, the good news in that otherwise grim story of corruption and, no doubt, collusion in public procurement is that Italy also possessed magistrates sufficiently courageous and incorruptible to indict a Prime Minister. Enforcing probity and adherence to the law in public procurement will inevitably bring the enforcement authorities up against powerful individuals and interests. When that time comes it’s as well that the general public be closely informed of its deep interest in robust enforcement of pro-competition and anti-corruption rules in the area of public procurement.