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**FIGHTING CORRUPTION AND PROMOTING COMPETITION**

**Contribution from Ms Tina Søreide**

-- Session I --

*This contribution is submitted by Ms Tina Søreide (Post-doctoral researcher in law and economics, University of Bergen, Norway) under Session I of the Global Forum on Competition to be held on 27-28 February 2014.*

Ms Ania Thiemann, Global Relations Manager, OECD Competition Division,  
Tel: +33 1 45 24 98 87, Email: Ania.Thiemann@oecd.org

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## FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Contribution from Ms Tina Søreide <sup>1</sup>--

### 1. Introduction

1. Societies at large benefit from sound private sector competition and trade openness. Well-functioning markets promote innovation and productivity while they also serve as efficient price controls to the benefit of both consumers and the private sector. At the same time, the pressure to perform and cut prices is exactly the pressure that induces some firms to create more or less legitimate obstacles to competition if they can. Corruption is an illegal tool applied by some players to avoid competition and still obtain market power and contracts. On the side of governments, politicians and civil servants are entrusted with authority and expected to make unbiased decisions to the benefit of society. Small bribes can make a big difference in their personal economy, and some of them are tempted to let decisions be steered in exchange for some benefits. Corruption can be more rewarding for government representatives the more they can enhance firms' market power. The exchange of benefits can take many forms and be quite subtle, often well covered by legitimate decisions and goals, and for outsiders it can be difficult to judge the true performance of both the government representatives and the private sector. What we can often observe, however, are the impacts of restricted competition which typically takes the form of higher prices, a drop in qualities or a limited selection of goods and services.<sup>2</sup>

2. Anticorruption became a central theme in the international development community in the mid-1990s. Since then we have seen remarkable progress in the anticorruption legislation, a result of consistent pressure from pro-development governments, civil society, the private sector and development partners.<sup>3</sup> A main concern now is how to get the laws enforced, not only in developing countries but also across the OECD. A recent report from the European Commission states that "EU Member States have in place most of the necessary legal instruments and institutions to prevent and fight corruption", but "the results they deliver are not satisfactory" and "declared intentions are still too distant from concrete results, and genuine political will to eradicate corruption often appears to be missing"<sup>4</sup> In terms of countries' different ability to control corruption Transparency International's National Integrity Studies include useful reviews of the legal and functional quality of integrity systems across Europe.<sup>5</sup> A main message from those studies is that

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<sup>1</sup> Economist at The Faculty of Law, University of Bergen and senior researcher at Chr. Michelsen Institute (CMI); tina.soreide@jur.uib.no. This paper draws on some of my former publications, including Søreide (2011a and b, 2012, 2013). Thanks to the organizers of the OECD Global Forum on Competition 2014 for the opportunity to contribute on this important policy agenda.

<sup>2</sup> For empirical analysis of corruption and competition, see among others Ades and DiTella (1999) and Bliss and DiTella (1997). For a recent review of studies relevant to understand the connection, see Olken and Pande (2012).

<sup>3</sup> See reports made available by U4, an anticorruption centre funded by development partners: at [www.u4.no](http://www.u4.no)

<sup>4</sup> European Commission (2014:2)

<sup>5</sup> See Transparency International's website for access to country assessments: <http://www.transparency.org/whatwedo/nis/P20>

many parliaments are not living up to ethical standards. Needed integrity safeguards, like mandatory codes of conduct, clear conflict of interest regulations and rules on disclosure of financial interests are not put in place. Political party financing is inadequately regulated, while lobbying “remains veiled in secrecy”. Access to information on government decisions is limited in practice, public procurement is a high risk area, and generally, whistleblowers who speak out about corruption are far too weakly protected.<sup>6</sup> These indicators of weak anticorruption barriers suggest a certain risk that market distortions occur as the result of various forms of undue influence. Nevertheless, the problem of corruption has often been considered primarily a governance issue separated from the function of markets. Those who study competition law and economics in academic or government institutions rarely address the issue of corruption as well. The most “attractive” forms of corruption, however, are the ones that distort the positive development outcomes of competition, and this is why we need to better understand this crime in a market context.

3. This paper discusses high risk areas of market-related corruption. In this debate we have to remember that market distortions happen for a whole range of other reasons than corruption. Politicians have multiple goals, they want to protect jobs and their constituents, or they are lazy or incompetent. These are all reasons for market distortions, but alas, they are also the excuses that can cover corruption. Also for firms there are many legitimate ways to exert influence on decision-makers and we get to the difficulty of distinguishing between different forms of grey zone practices in a few pages. The paper continues in Section 2 by discussing how corruption can be understood and characterized, why we must assess risks along the whole sector value chain (not focusing on tender-related corruption only), and why we need to understand how corruption is combined with other forms of crime – and especially, violation of competition law. In Section 3 we turn to policy concerns and areas where it is difficult to point at optimal solutions; some issues being technical while others are a matter of political will. Conclusion follows.

## 2. Corruption in market contexts

### 2.1 *Undue influence for preferential treatment*

4. To understand corruption’s influence on markets, we must consider what firms may find reason to bribe for. Corruption implies that the decisions they would like to influence are up for sale. Offering a bribe to win a tender is not the only way of setting competition aside. A firm will easily strengthen its hold on a market if given an exemption from competition law or principles. It will have much to gain from influencing decisions regarding mergers and acquisitions. Trade regulations and some more or less explicit entry barrier may boost its profit. Secret deals with a procuring entity may “allow” it to operate a cartel, influence tender criteria or obtain single-source supplier agreements for no legitimate reason. However, a firm’s profit and opportunity to secure a strong market position will depend not only on its revenues, but also its expenses. If equipped with exclusive tax benefits, cheaper access to credit than what competitors can obtain, or subsidies for parts of its production, a firm can easily offer lower bids than its competitors.

5. Undue influence can take place at different levels of governance. The most important decisions about trade and markets are subject to political judgment and firms may have much to gain from influencing their decisions. Politicians interfere with competition authorities (even if they are independent), influence the award criteria in big procurement decisions – such as infrastructure concession contracts, and keep trade politics open for modifications.<sup>7</sup> Sometimes they are willing to exert pressure on foreign governments in procurement matters. A trade-related conditionality in diplomatic negotiations is not corruption, but the resulting market distortion is often similar.<sup>8</sup>

<sup>6</sup> Transparency International (2012).

<sup>7</sup> This is a concern particularly in utility regulation, including across Europe; see chapters in Estache (2011).

<sup>8</sup> This is why Transparency International included governments’ propensity to exert diplomatic pressure for contracts in their early versions of their Bribe Payers Index.

6. Many attempts of influencing decisions are totally legitimate. How can we tell the difference between corruption and what's legal?

**2.2 Defining corruption**

7. Corruption is often referred to as the misuse of public authority for personal benefit. The authority will not have to belong to a government representative. There are serious challenges associated with totally private sector corruption as well, especially in tenders organized by large corporations. This note addresses corruption involving civil servants and politicians. Given the monopoly on government authority, the importance of trust in these institutions, and the different set of incentives within private and public organizations, public sector corruption is the most serious concern for society at large, although corruption distorts price-quality combinations also in private-private settings.<sup>9</sup>

8. In most countries, corruption is defined and regulated by the country's penal code. Legal definitions, however, will often include value-laden words, such as *improper*, *undue*, *disproportional* and so on. The contents of these terms need clarification. We all know examples of clear-cut corruption cases with illegal bribe-transactions, usually well-covered by the press. Most cases of undue influence are not that clear however, and many market players are uncertain if they act in compliance with the law or not.<sup>10</sup>

9. Table 1 below - with business practices listed on a scale from the totally acceptable to the clearly illegal, illustrate the difficulty of drawing a line between the legal and the illegal.

**Table 1.**

<i>LEGAL</i>				<i>LEGAL GREY ZONES</i>					<i>ILLEGAL</i>
Honest and professional business conduct Ordinary marketing Marketing targeted at specific individuals: exclusive excursions, sports tickets, gourmet evenings, etc. Unsolicited proposals, with all details of an unplanned project prepared Middlemen and agents, 'personal relationship is what counts' Gifts to political parties – by condition of a certain benefit Quid pro quos – a way of covering corruption? 'Facilitation payments' – 'to get the procedures going' Bargaining on opportunities for reconcessioning (profitable solutions for the firm) Violations of rules of communication (as if they were not important) Persuade politicians at home to put pressure on local govms. (difficult to prosecute) Acquire secret information about evaluation, use of 'fronts' Misuse of 'facilitation payments' (makes corruption 'less illegal') Expensive gifts to people involved in the tender procedure Buy secret information about competitors' bids Local partnership with relatives of people with authority Bribes to individuals with influence on the procedure									

Source: Author's compilation, previously used in Søreide (2006, 2011)

<sup>9</sup> For useful introductions to the theme, see Rose-Ackerman (1999) and Lambsdorff (2006, 2007)

<sup>10</sup> Many cases are presented at the Transparency International website: see [www.transparency.org](http://www.transparency.org). For a useful overview of cases pursued under the US Foreign Corrupt Practices Act, see the website of the Securities and Exchange Commission (SEC) and the FCPA map by Mintz Group: <http://www.fcmap.com/>

10. A rapidly increasing number of court cases help us get a better sense of what is legal or illegal, but a clear categorization of acts is difficult to establish since corruption is often context specific. A useful guiding device is to assess whether a market player's attempt of influencing a decision has the character of a trade. If there has been secret deal in which the decision-maker has obtained some form of benefit for himself, his allies, in the past or the future, the case will easily seem like a *trade in decision that should not be for sale* – and will thus fall in the corruption category.

11. Such an assessment will not dismantle all ambiguities, however. Consider lobbying for example. Firms and other actors must be expected to defend their interests; this is their democratic right. Payments in politics are hard to avoid and quite often, both parties to the deal wish to be secretive about it. How to distinguish between corruption and lobbying is addressed by Harstad and Svensson (2011). They explain how lobbying usually is intended to pursue the interests of a category of players, such as a whole industry or some other group of stakeholders. Corruption, on the other hand, is typically intended to secure a unique benefit for the actor that offers the payment – for example an exclusive tax benefit, sole source procurement deal or a subsidy. Lobbying can therefore be seen as an effort to *bend* a rule, while corruption is to *violate* a rule. Moreover, while lobbying (with payments) may fail to produce the desired result, corruption is typically a deal where the payment depends on delivery of the given decision. Besides, in contrast to most lobby payments, a bribe accrues to the personal economy of the corrupt decision-maker, where even small figures may matter a lot. Market players may achieve more through corruption (and cause larger market distortions) since the bribe compensates the decision-maker for the moral costs and risks associated with a deviation from rules and institutional goals.

### 2.3 *Risks along the sector value chain*

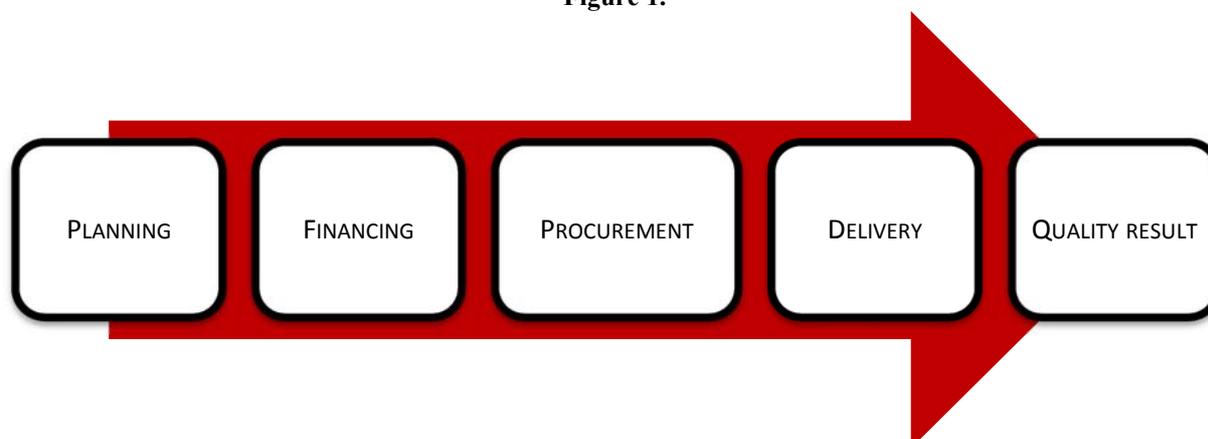
12. Public procurement is definitely an arena at risk for corrupt influence – even if procurement rules have been much improved in most places over the last 15 years. The risk of corruption has motivated many governments to reform their practices. Better rules and controls do reduce the problem, but the profit-making incentives among market players are still there, and a higher risk of detection may also increase the level of bribes since a higher risk of detection means that it will take more to compensate a decision-maker for the costs associated with involvement in the crime.

13. The forms and consequences of corruption in public procurement depend on the goods and products. Relevant aspects are level of 'on the shelf' character/uniqueness, the degree of discretionary decision-making, contract and product complexities, and whether those involved will face consequences if what procured does not match the need or the funds made available for the acquisition. Corruption in public procurement is much more than a bribe paid to a procurement agent. For each step of the sector value chain – including planning, financing, procurement, project delivery and eventually the presentation of a result - there are different corruption risks involving different players. If we want to understand distorted contract allocations in a market context, it is useful to identify those risks and most important decision-makers, and consider what rules, moral landscape and control practices will hinder them from taking part in corruption.<sup>11</sup>

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<sup>11</sup> For useful debate about corruption in public procurement, see among many others Della Porta and Vannucci (1999), Rose-Ackerman (1978, 1999) and Piga (2011). Guasch ( ) describes the risk of corruption in contract renegotiation with reference to utilities sectors.

Figure 1.



Source: Author compilation (used previously in presentations)

14. When it comes to the tender situation explicitly, we separate between forms of corruption that makes it look like as if all rules are respected, and corruption hidden as a legitimate deviation from the rules. Corruption in the first category is often covered in the choice of technology, short listing /pre-qualification, selected invitation to tender, biased discretion in the selection process, and secret agreements about ex post contract modifications. Corruption in the second category, where an excuse is made to set the standard rules aside, the corruption is more frequently hidden in bilateral negotiations, single-source agreements, or the lack of oversight in emergency situations or preparations for major events (Olympic games for instance).<sup>12</sup>

15. Privatization includes auctions similar to public procurement tenders, although investors bid by offering a price. Selling off state owned entities can be an efficient remedy against corruption and the existence of too close ties, for example with politicians offered compensated board positions in state owned entities while they also secure the entity subsidies and shield it from competition.<sup>13</sup> However, in these settings there is much to gain for the investors if some market power can be privatized together with the entity that is up for sale. Investors are likely to pay more if the privatized entity will be protected from competition, and some may offer illegal payments to secure such an outcome. Even if there are legitimate reasons to protect a newly privatized company we should be critical about the cases when an entity is allowed to operate for years with its public sector market power well intact.<sup>14</sup>

#### 2.4 *Corruption and collusion*

16. Illegal cooperation in prices, quantities or market allocation will be easier to carry out if those involved have a collaborator on the government side. For a corrupt procurement agent the crime may be more rewarding if those involved is provided with market power and more profits for sharing. The agent may coordinate necessary exchange of information between cartel members (who dislike exchanging

<sup>12</sup> For more details, see Della Porta and Vannucci (1999), Rose-Ackerman (1978, 1999), Søreide (2011) and Piga (2011).

<sup>13</sup> See Shleifer and Vishny (2003) for analysis of the game, Bel et al. (2014) discusses close ties between politicians and firms in Spain's construction sector.

<sup>14</sup> For illustrative cases, see Manzetti (1999) and Black et al. (2000). The price-competition trade-and risk of corruption are studied by Auriol and Straub (2011) and Bjørvatn and Søreide (2005).

information even if they benefit from the collaboration) and punish those who deviate from the secret deal. Most importantly, however, the agent can cover the collusion by allocating contracts according to secret cartel rules, while making it look like as if all procedures have been respected. Lambert-Mogliansky (2011) explains these mechanisms and points at reasons to assume that cartels are quite often facilitated by corruption.<sup>15</sup>

17. Some sectors are particularly exposed to the combination of corruption and collusion, and among them we find infrastructure, utility provision and construction.<sup>16</sup> Since market distortions in these sectors take similar character across countries with different institutional qualities, they may have intrinsic features that impede well-functioning market forces. Contracts in these sectors are generally large and complex with a lot of details kept confidential or too complex for outsiders to assess, each project is unique, and tenders are (fairly) easily manipulated. When it comes to the construction sector, Wells (2014) explains the corruption risk in light of a mismatch between information supposed to be present at the stage of planning and decision-making and what information is actually available. Standard procedures at the early stages of the sector value chain are based on an assumption that much more information about the project is available while in practice, this is not necessarily so. At the planning stage, decision-makers do not necessarily have a full overview of financial matters, future demand for services and buildings or technical obstacles, and frequently, they have to adjust or deviate from former decisions. If pragmatic departure from plans and programmes are expected, it becomes easier to get away with corruption. The need to take into account additional concerns and facts or renegotiate deals is common and will rarely be questioned from an anticorruption perspective. These characteristics are what allow for what Flyvbjerg, Bruzelius and Rothengatter (2003) consider a tendency among “all the players around the table” in the planning phase of large construction projects to inflate project size and total price while demand estimates are manipulated to defend the scheme.<sup>17</sup> Corruption in these contexts should not be understood and investigated as a stand-alone illegal transaction, but seen in context of more serious sector governance dysfunctions and investigated as one element in a larger scheme involving a set of different players.

### 3. Policy solutions

18. Among the direct consequences of market distortions caused by corruption are higher expenses and lower value for money in public procurement and privatization. The indirect consequences are more subtle though equally serious in terms of distorted allocation of talents, reduced state legitimacy and lower motivation for innovation. Corruption is criminalized because of the serious damage it causes. Those involved can be sentenced to years in prison and heavy fines. Most OECD members place criminal sanctions on organizations, not only on individuals, and those involved can be held liable in their own country for corruption conducted anywhere in the world. Over the last 15 years we have witnessed tremendous progress in the development of a legal platform for holding individuals and firms responsible for corruption, an agenda pushed forward by the OECD. International anticorruption conventions have led to legal reform in countries all over the world, a result which would not have been possible without diplomatic collaboration and consistent political pressure over years. There is definitely political will to implement laws to fight corruption. The challenges now relate to how we enforce the laws, how different legal tools and investigating institutions function together, difficulties in determining the right policy solutions on certain issues, and internationally, we struggle with asymmetric law enforcement across countries. These aspects are now addressed in turn.

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<sup>15</sup> Combined corruption & collusion have taken place in the award of removal of rubbish contracts in the south of Italy, a sector with severe problems for more than fifteen years. In 2009 a central politician was accused of providing outside support to the illegal activities of the camorra mafia in relation to the collection, transportation, and disposal of garbage in the Campania region.

<sup>16</sup> On the website of the EU Commission there are cases of undue influence and collusion in several sectors, for example air freight and freight forwarding services, the electricity sector and ICT; cases where sectors have been accused of abusing their dominant position and profited too much at the expense of consumers.

<sup>17</sup> See also Flyvbjerg and Molloy (2011), Stansbury (2005), Kenny (2009) and Valence (2011).

### 3.1 *Anticorruption laws*

19. Policy solutions include efforts to detect and prevent corruption, as listed in Table 2. Although corruption is regulated by criminal law, relevant anticorruption legislation consists of a whole set of laws, and we can separate between the laws regulating the private sector and those regulating the public sector.

**Table 2.**

Undue influence/ corruption	Legal approaches	
	<i>Prevention</i>	<i>Disclosure</i>
Decisions regarding private sector	Competition law, procurement rules, criminalization of corruption, employer liability,	Audits, leniency, whistle-blower protection, confidentiality-rules, access to information laws
Undue influence at political level	Public lobby register, impartiality requirements	Media, watchdogs, whistleblowers, auditors

Source: Author's compilation

20. In the private sector employers and even owners can be held responsible for the corruption committed by employees to promote the interest of the company. This is an area where the legislation is still immature in most OECD countries, and for many leaders in the private sector there is uncertainty about what exactly they can be held responsible for. Given grey zone practices, as discussed above, many business leaders find it unclear how to interpret the law. Drawing a line between the practices listed in Table 1 is difficult, and even if clarification is demanded by the private sector, and to some extent offered by some OECD governments, we should be cautious not to give a green light on acts that can in some settings be legitimate while in others, they cover or is a form of corruption. Increasingly over the last decade firms have introduced control procedures and compliance rules within their organizations, often upon significant pressure from the business community itself, civil society or as the result of legal demands. Such initiatives contribute to improve the 'the moral landscape' in private sector organizations. It also promotes collaboration with investigators when cases of corruption are nevertheless coming up, and reduces the consequences firms have to face if found guilty. Firms' intrinsic profit-making incentives are nevertheless still the same, and even if the barrier for corruption has gotten higher, the risks of corruption are far from eliminated.

21. When it comes to the government side, one of the tricky questions is how to balance discretionary authority and controls. Too many controls are demotivating on honest decision-makers. Detailed rules make it easier to spot deviation, but are costly to control. 'Red flags' driven investigations, i.e. that certain indicators associated with risk of corruption trigger investigation if left unexplained, are useful but increases the risk that some forms of corruption are not detected as long as all procedures appear to be respected (Kenny and Musatova, 2011). Allocation of responsibilities combined with outcome controls will often be a good solution (if outcomes are at all observable), but requires significant trust in civil servants to allow them discretion in the first place. However, corruption risks at political levels in OECD countries, mentioned introductory, should encourage governments to conduct a sincere quality assessment of the checks and balances at their highest level of governance. Parliamentary controls, national audit offices, independent courts, a free press and a vivid civil society promote political accountability, but are often not sufficient when it comes to the protection of markets and consumers. The politics related to industry regulation are often a complex matter and subject to multiple political goals, including populist goals in conflict with well-functioning market forces. There are legitimate reasons for protecting other values than market mechanisms, but given the many available "legitimate excuses" that may direct a

decision away from competition and towards overly preferential treatment of a given company, it matters crucially how we secure competent control on such political judgments.<sup>18</sup> Those with political sector oversight responsibility should make public their explanation of their decisions and aims where they also explain what results are expected in terms prices and qualities, as well as other values, such as environment, private sector investment, jobs etc. The general public must be allowed to make their own assessments of the value for money in such political priorities.

22. Anticorruption legislation, including the laws regulating the private and the public sector, is designed with a view to secure sound decision-making processes. However, a focus on procedures is not necessarily sufficient to address corruption as a cause of market distortions. Following from the Section 2 discussion, the risk of corruption is higher the (i) more politicized the sector regulations; (ii) the larger the space for discretionary judgment; (iii) the more monopolized the decisions that matter for private sector profits; and (iv) the less access the public and control bodies have to information. This is a complex policy area, procedures are overruled and it is difficult to distinguish between legitimate and illegitimate reasons, and we have to link assessment of performance to the observed market results, and this calls for collaboration between anticorruption law enforcement and market observers.

### 3.2 *Competition control and criminal law*

23. If market distortions are the problem we wish to contend, why is it that do not simply direct efforts at stronger competition and market controls since corruption is likely to evaporate as one of the several positive results of such an effort? This is a valid point, as efficient protection of markets will make corruption more difficult. While price-quality combinations may improve, which is an ultimate aim in this context, we still have a problem if we fail to reach those involved in corruption on the side of governments. If the individuals who caused the market-distortions stay in office they may just as well cause other market distortions in exchange for personal benefits. We should definitely avoid a situation where individuals in positions for biased decision-making get a feeling of impunity.

24. Those involved in relevant decisions have to sense a risk of being held responsible. For practical and legal reasons, this is not a simple matter when it comes to civil servants. State bureaucracy *means* allocation of discretionary authority. Since controlling each and every decision a civil servant makes is costly both in terms of expenses and demotivating effects, the risk of corruption will easily be an unavoidable side-effect of efficient state organization (although we can choose to keep the risk low). There will always be circumstances where civil servants or politicians can direct benefits to a certain market player, with or without corruption. Those in best position to detect the results of such biased decision-making are the market observers.

25. A competition authority is in far better position for revealing market distortions than the criminal justice system. The focus for competition authorities, however, is rightly to fulfill their mandate anchored in competition law, and most such laws say nothing about corruption. Representatives of competition authorities are *not supposed* to investigate an indicator of corruption. In some countries there is close collaboration between competition authorities and criminal law investigators, while in others, and particularly the civil law countries, there is a clear separation between such authorities. For more efficient corruption control in markets, however, these institutions have to collaborate closely.

26. One of the reasons why this can be difficult in practice is the competition authorities' opportunity to offer leniency in cartel cases, which means that a cartel member can avoid sanctions if revealing the case to the competition authority, an arrangement introduced to increase the number of cases revealed. Competition authorities, however, can offer leniency for violations of competition law only, and not for acts regulated by criminal law. If cartels are combined with corruption, the leniency tool is set out of

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<sup>18</sup> For debate and examples, see Benitez et al. (2012)

function if competition authorities work too closely with criminal law units. Criminal law investigators will easily find themselves in a catch-22 situation since ‘whatever they do is wrong’: if ready to investigate any indicator of corruption or other financial crime found by a competition authority, they weaken the effect of leniency and fewer cases may get revealed. If they keep distance to the competition authority, for instance upon informal agreements to stay away from investigating unless ‘invited’ to, they may fail to fulfill *their mandate*, which is to investigate cases of crime. The formal and informal collaboration between competition authorities and criminal law investigators differs across OECD countries and one solution may not fit all. What is important is that different authorities in a country understand how corruption and violation of competition law are often combined, sometimes also with other forms of financial crime, and let their institutions be designed to cope with such complexities.

### 3.3 *In search for policy solutions*

27. Even with a clear ambition of promoting competition and combating corruption, there are policy areas where the optimal solution is unknown. When there is no coherent understanding of what works we see countries go in somewhat different policy directions. This section points at selected areas in need for more understanding and harmonized solutions.

#### 3.3.1 *Anticorruption priorities*

28. Most governments have limited funds for crime control and with scant resources the question of how to prioritize cases becomes an important part of an investigative unit’s strategy. Ideally policy priorities should match an understanding of what is more or less harmful to society. When it comes to corruption, we will often consider the damage caused in terms of how decisions are distorted, and not the size of a bribe or contract values. Table 3 suggests categories of damage listed with relevant circumstances exemplified. To get a sense of the possible distortions we consider what benefits are obtained through corruption and whether the corruption causes scarcity with the effect that services are not delivered to all who are eligible for them or they have to pay higher prices.

**Table 3.**

CATEGORIES OF BENEFITS	DISTORTION	EXAMPLES
<b>ILLEGAL BENEFIT</b>	The costs/consequences of the crime	Terrorism, import of illegal drugs/weapons, permission not supposed to be offered
<b>LEGAL BUT SCARCE</b>	Allocation of benefits based on willingness to bribe instead of needs /competition	Health services, education, public contracts
<b>LEGAL BENEFIT <i>MADE</i> SCARCE</b>	Limited allocation of benefits (would be available without corruption)	Public welfare, customs
<b>NO SCARCITY &amp; BENEFIT</b> supposed to be free of charge (bribe demanded)	Informal tax on consumers	Access to utility provision (electricity, water)

Source: Author’s compilation based on Rose-Ackerman (1999)

29. Indirect consequences are not included in this table, and these categories cannot be translated directly into investigation priorities. The point is to underscore the importance of letting priorities match risks to society, and for that purpose, we need to understand the risks.

### 3.3.2 *Liability and sanctions*

30. In the prosecution phase there is often uncertainty regarding who should be accused of corruption even if the evidence in the given case is clear. Especially the combination of individual and corporate liability is difficult in practice. As a fundamental principle in criminal law we want to place blame on individual decision-makers. At the same time, by placing blame on individuals only, firms (and owners) are given space to profit from corruption and place the blame on scapegoats if caught in the crime. Placing sanctions on firms only, on the other hand, will make it possible for individuals to benefit grossly from the crime (particularly if wage leaps and bonuses are tied to successful contracting), while they avoid personal responsibility if caught in the crime. Besides, a company will typically consist of a significant number of innocent employees. For their motivation and productivity it makes sense to have dishonest leaders removed and let them go on with their good work.

31. Law enforcement institutions differ in their views on the right combination of individual and group sanction. An aspect often forgotten in the debate is the consequences of corporate sanctions on competition in markets. From an economic perspective, there is not much sense in placing a very low fine on a large company. It will not affect the margins and business can carry on as if nothing has happened. From a legal perspective, however, even a small fine singles out a company for blame – which is an essential part of law enforcement. But the effect of a court process, and the ability of the accused to feel guilt, is very different if individuals are held responsible compared to the case of corporate liability. On the other hand, a substantial fine may not only hit the company hard, it hits back on society. Especially in markets with few firms the verdict will be celebrated by competitors. Reduced competition allows them space to secure higher revenues while their clients face higher expenses. The sanction itself distorts the competition we want to protect.

32. Even for the sake of competition, however, we should not scale a sanction to the accused company's market power since that will easily imply lower sanctions the stronger and bigger you are. The same legal principles should apply for firms in different market positions. What we should seek to achieve are sanctions with deterrent impact on decision-making combined with few consequences on the firm's ability to operate in the market. Such ambitions suggest individual liability, but it can also imply strict external controls placed on the company's internal decision-making processes and operations – a sanction many business leaders abhor.

### 3.3.3 *Debarment*

33. The debate on sanctions has parallels to debarment in public procurement. As a consequence of a criminal sanction, a firm may be debarred from taking part in public tenders. The purpose of this arrangement, which is anchored in procurement law, is to protect public investments from crime and keep voters' trust in public authorities. For a company, however, debarment may well feel as an added penalty, particularly if the exclusion from markets hit them harder than the criminal sanction itself. In these cases there are clear risks of distortive consequences for the competition since market players are actually excluded from the market, often for years. Oligopoly markets are vulnerable to such consequences, and again, we should consider how competition can be protected while trust in public institutions is still secured. A possible solution is to debar a company found guilty for a significant period of time, and let it have its debarment period reduced upon efforts to regain status as trustworthy, for example by accepting external control, introducing better compliance system, removing dishonest leaders and so on. The procurement regulations require "proportional" consequences and "equal treatment" of competitors. If a

firm has conducted sufficient “self-cleaning” initiatives, it should be considered “equally trustworthy” (and not “equally *untrustworthy*” as other firms found guilty with no such compliance initiatives), and thus, allowed to take part in public tenders. It is up to each country to find solutions, including within the EU where the new procurement guidelines offer space for country-specific solutions. Given the international character of markets, however, there should be a harmonized ambition about the protection of competition in these cases (at least there should be a joint ambition of *not ignoring* the market consequences!)<sup>19</sup>

### 3.3.4 *Consequences for the contract*

34. A further question coming up as firms have been found guilty in procurement-related corruption, or where corrupt benefits in other ways secured it a contract, is whether the contract should be stopped and retendered or allowed to continue. Voiding the entire deal may be very costly for the clients and citizens who benefit from the contract. Investments already conducted may become worthless and repeating the tender is costly and time-consuming. One solution is to allow the company to complete the contract but impose on it a fine that is high enough to effectively imply a negative net gain from the contract, as Lambsdorff (2013) suggests. Another option, pointed out by Rose-Ackerman (2013:27), is to auction off the right to complete the contract. This could be a wise decision in cases where the relevant competence is available in rival firms and where the guilty firm is unlikely to undermine or sabotage a rival’s completion of the project. Also in this policy area it is difficult to describe absolute solutions. What governments have to consider when they specify their rules is the trade-off between penalizing the corrupt firm and assuring smooth completion of the project.

### 3.4 *Asymmetric law enforcement*

35. The variation we observe when it comes to governments’ political willingness to address corruption is a very different concern. This too must be understood as a “technical policy challenge” but the question now is not about how the details of law enforcement initiatives and institutions should be designed, but how to get them implemented. Some politicians are inclined to set aside important development goals if they come in conflict with their personal goals, wealth and power being the most typical categories. The references mentioned introductory, especially the recent EU report on corruption (European Commission, 2014) and Transparency International’s National Integrity Studies, suggest that such risks are not exclusively a developing country challenge. The risk of corruption within their own political environments must be taken seriously by all OECD governments. Moreover, governments enforce cross-border anti-bribery legislation very differently. Low capacity is one possible reason, but there are still those who condone bribery for business advantages..<sup>20</sup>

36. Weak enforcement of anticorruption laws distorts international markets. In cases where competitors from different countries face few consequences of corruption in the country where the crime takes place, (for example if the political level benefits from the crime), and different risk of being sanctioned at home, they operate under very unequal terms. Honest players (i.e. players who cannot take the risk) compete with players who face no consequences if they cheat. The competition which should have been in prices and qualities becomes a competition between productivity and bribes; i.e. how productive must the honest firm be to be preferred by a corrupt decision-maker when competitors offer bribes.<sup>21</sup> Even

<sup>19</sup> The mechanisms discussed are described in more detail by Hjelmeng and Søreide (2013, 2014). See also Dubois and Nolan (2013).

<sup>20</sup> See the OECD Directorate for Financial and Enterprise Affairs: <http://www.oecd.org/daf/anti-bribery/> where reports on country performance are published, Consider for example the political protection of the BAE in the UK, a case well described at *The Guardian*’s website: <http://www.theguardian.com/world/bae>

<sup>21</sup> Bjorvatn and Søreide (2013) offer an analysis of the mentioned game with a focus on competition for licenses for natural resource production.

if such games could induce some firms to more, the overall impact is obviously damaging, and many players will stay away from tenders if they think contracts are allocated on dishonest criteria. The asymmetry in law enforcement is damaging for international trade, and we have to do much more to sell the concept of fair competition in all markets as a public good idea.

37. A related challenge is financial secrecy. Over the last five years we have seen significant progress on the issue of tax havens. Many of the classic tax havens (i.e. the islands with palms) operate now in line with FATF initiatives in terms of registering required information and collaborating with investigators in cases of outright fraud and corruption. However, there are still service providers – including in the OECD countries – that offer secrecy and makes it possible for market players to keep their true ownership hidden.<sup>22</sup> The puzzling issue is that policy makers in some countries seem to condone the potential market consequences; at least, there are surprisingly few attempts of tax reform across Europe.. One concern is the illegal tax avoidance which allows the most creative players to generate huge wealth which subsequently can be used to outcompete competitors. If you are rich enough you can easily keep prices below costs for a while. Tax evasion and avoidance by some players have created damaging chain effects; if my competitors gain by overly creative tax planning I have to be creative too. The tax evasion and avoidance have led to significant losses in state revenues for OECD countries, several of them being forced to cut public spending which means cuts in social services, health and education systems and eventually a risk of higher unemployment and civil unrest as the result. Such consequences threaten framework conditions for productivity and well-functioning markets. Moreover, the issue of secret ownership makes it possible for some actors to avoid being held responsible for their acts and decisions, which paves the way for profiting from criminal practices – like corruption, slavery and illegal trade.<sup>23</sup> It also opens for the scenario where individuals with sector oversight responsibility on the side of governments actually own the companies they regulate. Given these different concerns, the hesitance among some OECD governments to address the issue of secret ownership is hard to understand if it is not about protecting very narrow interests. The potential consequences for competition, crime and the world economy cannot be ignored.

#### 4. Conclusion

38. In order to understand corruption in a market context we need to consider what decisions firms may want to influence, and assess the reasons and barriers that prevent them from doing it. Firms can exert pressure on decision-makers in many legitimate ways, however, and corruption is context-specific; it will often be difficult to draw a categorical line between legal and illegal practices. The more a firm's effort in influencing deals, terms and contracts has the character of a trade in decisions that are not supposed to be for sale, the more it resembles corruption. Market-related corruption occurs in many forms, and is not exclusively about bribes to secure contracts. It is also about cutting costs, influencing planning, securing protection from competition, and avoiding controls – for example on auditing or product quality. There are risks along the whole sector value chain and how the corruption plays out depends on the sector and regulating institutions. Some sectors – like utility provision and the construction sector - are more exposed than others. When serious dysfunctions are observed in many countries we may have to rethink how the sectors are organized and governed since anticorruption controls are not necessarily enough to get rid of the distortions. A further challenge is how corruption is often combined with other forms of crime, including collusion and fraud. In several OECD member countries the institutions supposed to detect corruption, violation of competition law and fraud are designed to address individual forms of crime. The high risk that forms of crime are combined may call for some institutional reforms.

<sup>22</sup> Shaxson (2011) offers background and detailed introduction to the challenge of financial secrecy. Tax Justice Network publishes a Financial Secrecy Index: <http://www.financialsecrecyindex.com/>.

<sup>23</sup> The German company Siemens was penalized for paying bribes to gain big public contracts in several sectors and countries, including concession contracts, a practice made possible by the presence of tax havens and secrecy practices, including in European jurisdictions.

39. When it comes to policy considerations, this brief note has pointed at status and challenges for the most obvious law enforcement components, like investigation, prosecution and sanctions. It is important to let anticorruption priorities match an understanding of damage caused to markets and societies. When it comes to how we hold firms and individuals responsible for corruption, we must prevent criminal corporate sanctions and debarment in public procurement from distorting competition (too much). Given evidence of tender-related corruption it should be straightforward to harmonize principles of how to handle the contract, i.e. whether it (or remaining work) should be retendered or whether the (corrupt) operator should be allowed to continue the project or service delivery.

40. Some of the most serious obstacles to efficient anticorruption in a market context are not about what policy initiatives should look like but rather, how to get them implemented. Political will varies surprisingly much across countries, including among OECD member countries. Governments are generally slow to enforce anticorruption legislation and some are totally ignoring their responsibilities on cross-border bribery. Financial secrecy and the opportunity to keep ownership secret seems to be condoned by some governments, despite the damaging consequences on markets and societies.

41. Corruption in governments and markets must be combatted from several angles. Important elements of anticorruption, in addition to those addressed in this brief discussion, include the many initiatives introduced by the private sector itself, initiatives vis-à-vis developing countries fronted primarily by the development community, the international legal regime for resolving commercial disputes (including arbitrators and private litigants), and a diverse but important group of international non-profit institutions with an anticorruption and good government agenda.<sup>24</sup> What is important now, however, is that OECD governments understand corruption, not only “only” as a governance issue or development agenda, but as a threat to their national and international economy.

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<sup>24</sup> See Rose-Ackerman and Carrington (2013) for insightful debate about the role of international players in anticorruption.

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