

Unclassified

DAF/COMP/GF/WD(2014)26

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

23-Jan-2014

English - Or. English

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

Global Forum on Competition

FIGHTING CORRUPTION AND PROMOTING COMPETITION

Contribution from India

-- Session I --

This contribution is submitted by India 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

JT03351444

Complete document available on OLIS in its original format

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.



DAF/COMP/GF/WD(2014)26
Unclassified

English - Or. English

FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Competition Commission of India * --

Executive Summary

1. Corrupt and anti-competitive conducts are efficiency-reducing actions and cause adverse effects on economy. In certain quarters of anti-competitive assessment, it would appear that the *raison d'être* for market or consumer grievance is a corrupt practice, which palpably distorts competition without falling within the four corners of direct breach of competition law. Such situations reveal proximity of impacts caused by corrupt conducts and anti-competitive conducts on economic performance in a jurisdiction. Given this proximity, it has been an uphill task for competition authorities to segregate corrupt conduct from the anti-competitive conduct.

2. Economic literature shows that corruption may create regulatory hurdles that have little purpose other than that of rent generation and extraction. In these instances the causal link is from corruption to lowering of competition. The literature does recognize that it is the promise of rent that incentivizes a firm to collude with its competitors or to take action designed to exclude rivals from its market. However, most of the competition authorities across the globe have not yet recognized corrupt conduct as anti-competitive conduct.

3. In the Indian context, corruption and anti-competitive conduct are treated under different legislations. The Central Vigilance Commission is a watchdog on corruption, whereas the Competition Commission of India prohibits and punishes anti-competitive conducts as per provisions of the Competition Act, 2002.

4. Competition Commission of India has not done any empirical study or economic modelling to approve presumption that no bribes can occur in markets in which perfect competition prevails or increased levels of competition in the economy may experience upsurges in corruption. But in matters of public procurement, some cases have been brought before the Commission wherein specific regulations or terms of procurement by the public authority favouring one or more enterprises have been alleged. All such cases have been examined from the perspective of the provisions of the Competition Act, 2002 and the Commission has clearly dissociated itself, as of now, from considering corrupt conduct as anti-competitive. In public procurement cases, the Commission has ruled against parties, only when provisions of the Competition Act, 2002 have been breached by the conduct of parties. Furthermore, the Commission has not yet considered and approved collusion of bidder and procurer as bid rigging prohibited under the Act.

* Submission from Competition Commission of India for facilitating deliberations in Roundtable on Fighting Corruption and Promoting Competition scheduled on 27 February, 2014 during the OECD Global Forum on Competition in Paris on 27-28 February 2014. The views expressed in this document are without prejudice and does not reflect opinion of the Government of India. Competition Commission of India is not bound by the opinions expressed in the document while discharging its functions under the provisions of the Competition Act, 2002. The contents of this document are meant for deliberations and discussions only. For any clarification please contact international@cci.gov.in

1. Background

5. Corruption is an evil that has many damaging effects in any economy, including the distortion of incentives and misallocation of resources. Although corruption may be all pervasive vis-à-vis sectors of economy yet the impact it has on competition, calls for rigorous assessment by competition authorities.

6. Despite ample evidence at micro-level on the prevalence, scale and damaging effects of corruption, researchers generally do not find a negative and significant relation between corruption, measured by a number of indexes provided by international organizations (most notably the Corruption Perception Index, or the CPI, published by the Transparency International), and economic growth in cross-country studies. One reason for this interesting and perhaps puzzling fact is that these indexes are imperfect measures for the multiple facets of corruption. Another reason may be that negative effects of corruption on growth differ significantly across countries. For example, in developing countries like China and India, alleged rampant corruption has not slowed down growth, but in many African and South American countries, its effects seem far more damaging.

7. Indian economy is one of the largest in the world and it fares pretty well in some of the global competitive indices. India stands ahead of many emerging economy peers in terms of the strength of the financial institution, business sophistication and innovation. There may be many perceptions regarding corruption and its prevalence in India but institutional developments in the post liberalization era (1991 onwards) have built international confidence in Indian economy and institutional strength.

8. Competition Commission of India (CCI) is established by the Government of India under the mandates of the Competition Act, 2002. CCI is the only institution/authority in India vested with powers to prohibit anti-competitive practices and promote competition in markets in India. As far as corruption is concerned CCI does not exercise any authority regarding prohibition or punishment and any conduct distorting market/competition must fit into provisions of the Competition Act, 2002. Thus rise of rent seeking behaviors, owing to corruption, may not be directly remedied by CCI under the provisions of the Act.

2. Impact of Corruption

9. Corruption is a serious economic issue as it adversely affects the country's economic development and achievement of developmental goals. It promotes inefficiencies in utilization of resources, distorts the markets, compromises quality, and negatively affects the economy. It adds to further deprivation of the poor and weaker sections of the economy. Various attempts have been made to indicate the impact of corruption in quantitative terms. Some estimates show that government loses about ` 2 Trillion annually due to tax evasion while about ` 400 Billion is lost due to delay in projects¹. Transmission and distribution losses in the Power Sector are estimated to be about 50 per cent, out of which about 30 per cent is attributed to theft in connivance with the Electricity Boards employees². These estimates go a long way in hinting the regressive and distortionary impact of corruption on the economy.

¹ Battling India's malaise of Corruption, Address by CVC to the India CEO Forum Organised by International Market Assessment India Pvt. Ltd. available at <http://cvc.nic.in/CEO.pdf>

² DasGupta, A. and D. Mookherjee, Incentives and Institutional Reform in Tax Enforcement: An Analysis of Developing Country Experience. 1998, New Delhi: Oxford University Press.

2.1 *Causes of Corruption in India and the Anti-Corruption efforts undertaken*

10. The important causes of corruption in India may be many including regulatory framework, process of decision making aggravated by discretion and official secrecy. Social acceptability and tolerance for corruption is also a reason that propagates corruption further. The anti-corruption laws and institutions coupled with a strong oversight system consisting of the Central Vigilance Commission (CVC), the Comptroller and Auditor General (CAG) and the Central Information Commission (CIC) have been well acknowledged. But there is a huge gap between the policies and practice.

11. For instance, Public procurement as an economic activity may highly be prone to corruption and competition distortion. This distortion has serious impact on the industry as well as the market. The CVC created in 1964, became an independent statutory body in 2003 by an Act of Parliament maintains a high focus in this area. Its mandate is to oversee the vigilance administration and to advise the executive in matters relating to corruption. It investigates cases of corruption arising out of complaints or detection by vigilance wings in the various departments and recommends punishment wherever required.

12. One of the preventive strategies successfully deployed by the CVC, the CAG, etc. is the leveraging of technology to combat corruption, by persuading organizations to adopt IT and automate the activities and process vulnerable to corruption. An important requirement for the success of anti-corruption efforts is that it should be participative i.e. involve all the stakeholders and establish coordination among all agencies fighting corruption. Indian authorities focus on these efforts while combating corruption and maintaining competition wherever required. The Competition Commission of India does recognise the role of technology in busting cartels and bid-rigging.

3. *The linkage between Competition and Corruption*

13. An economic approach to controlling corruption would suggest increasing competition as a way to reduce returns from corrupt activities. This approach is based on the presumption that no bribes can occur in perfectly competitive markets as there are no excess profits from which to pay the bribes. Moreover, practical experience seems to show that countries that have increased levels of competition in the economy have sometimes experienced upsurges in corruption. It appears that a policy on competition is a simple instrument for controlling corruption, yet economists have not fully identified the conditions under which an increase in competition will effectively reduce corruption.

14. Anti-corruption efforts in India have been largely focused on the Public Sector which is called the “demand side” in the parlance of corruption economics. The private sector, which forms the “supply side”, actually pays the bribes, has been largely ignored. The supply side theories often put the onus of fighting corruption on the private sector. It states that firms pay bribes primarily for overcoming their shortcomings in terms of poor quality of their products/services, high prices of their products or to create a market for their goods which otherwise are not in demand. Thus they pay bribe to stay in competition despite these handicaps or to avoid true and fair competition. Corruption is the anti-thesis of a free, fair, competitive and efficient market, as it distorts the objectivity, transparency and fair-play in the market.

15. It may therefore be argued that business entities are obliged to maintain integrity in order to maintain the efficiency and sanctity of the market. It would be self-destructive to distort the very market on which they are dependent for their existence. Therefore the theory of corruption economics would advocate that given an opportunity, if the fears of the private sector are allayed, they will stand up against corruption. It is this thinking that has given rise to instruments like Code of Conduct and Integrity Pact through which private sector may be involved in fighting corruption.

International efforts have equally focused on tackling the “supply side” of corruption and most of the countries have their own systems or are signatories to Anti-Bribery Conventions. This is aimed at achieving fair-play and competitiveness in international business. International economic and financial organizations are strongly pursuing this. In particular reference to India, section 3 of the Competition Act, 2002 creates a supply side check on the distortionary practices relating to competition e.g. prohibition of bid-rigging under section 3 (3) of the Act.

3.1 Corruption in Procurement

16. Is corruption only a transfer between the briber and the bribed, or does it inhibit competitive pressures and allocative efficiency? What are the links between corruption and competition? What are the impacts of controls and public market procedures on corruption, firms' profits, and government expenditures? These are the questions that need to be answered. Corruption is recognized as a serious issue in a large variety of economic contexts. The effect of corruption on price competition may be much more dramatic than a mere transfer from the government to the bureaucrat.

17. In order to combat the above there is need for evolving processes, which can reduce corruption and restore competition in prices. One process may be of controls on firms and public officials. Corruption controls on efficient firms may restore competition in prices (to some extent). An efficient firm subject to controls is ready to harden price competition in the price-auction stage: it needs to compensate for its comparative disadvantage in bribe competition. By proposing a low enough price, it can make sure that other less-efficient firms cannot afford to compete in bribes. This behavior kills implicit collusion in the price-auction game and, at the same time, mitigates corruption and collusion with the procurement officials.

18. The main insights and arguments that flow from the above discussion is that corruption may affect competition because opportunities given by a corrupt public official provide firms with a mechanism to enforce collusion in price. The effect on contract price goes far beyond the mechanical price increase that might result from firms expecting to pay some given bribe to the public official.

3.2 Corruption, Competition, and Efficiency

19. Corruption has different efficiency effects across countries. Conventional economic models of Corruptions are shown to be deficient in explaining these differences. The efficiency effects associated with corruption depend on the way in which the rights to be transacted are selected and the terms under which the bargaining over their allocation happens. Conventional models analysing the efficiency implications of corruption are deficient because they ignore how rights are selected and the political constraints on their allocation process. One of the important factors affecting these processes is the distribution of power between the state and the organizations competing over the creation or reallocation of rights.

3.3 Corruption, Competition and Rent Behaviour

20. The cross-country subjective analysis shows that corruption is negatively associated with private investment and growth³. It has also been argued that the way to reduce corruption is to reform the legal system so as to increase the punishment or malfeasance. The economist's natural approach to corruption control is to appeal to the concept of competition as it is argued that bribes are harder to sustain where perfect competition prevails. Theoretically the effect of competition on corruption is ambiguous. Less

³ Mauro, Paolo, “Corruption and Growth”, *The Quarterly Journal of Economics*, Vol. 110, No. 3 (Aug., 1995), pp. 681-712, The MIT Press

competition means firms enjoy higher rents, so that bureaucrats with control rights over them, such as tax inspectors or regulators, have higher incentives to engage in malfeasant behaviour.

4. CCI Approach to Combating Corruption

21. As mentioned in preceding pages, in the Indian context corruption and anti-competitive conducts are treated under different legislations. CCI does not regulate corruption or corrupt practices but it does recognise that in some cases corrupt practices may palpably have adverse effect on competition. This implicit relation between corruption and competition does not vest anti-corruption jurisdiction in CCI.

22. As mentioned earlier, the CVC is an anti-corruption watchdog in India, whereas CCI prohibits and punishes anti-competitive conducts as per provisions of the Competition Act, 2002. CCI is committed towards building an environment which is cross-institution friendly, meaning thereby that CCI is not opposed to the idea of cooperation with the anti-corruption authorities to make market fair and competitive in India. CCI remains watchful regarding arrogation of direct market power created and sustained through trade barriers, manipulation of prices and collusion, acceptance of welfare reducing mergers or acquisitions, or favourable agreements on sole-source supply to governmental institutions. As such conducts/activities may have corruption and competition interface and may require immediate action either by the anti-corruption authority or by CCI. Arrogation of direct market power when purely due to corrupt conduct CCI may not interfere, however, when it results into providing involved firms higher profits, higher prices for consumers, or reduced quality or supply of goods and services, it may also have adverse effects on competition. In such scenario, cases may require scrutiny by CCI and the role of competition authority becomes relevant.

23. The relationship between corruption, production costs and competitive advantage needs more clarity in order to allow competition authorities to analyse competitive effects in cases involving corrupt and anti-competitive conduct. CCI has looked into number cases of bid-rigging, where collusion between bidder and procurer has been alleged. In close scrutiny, such allegations are favouritism to one or more enterprises or in simple terms alleged conducts of corruption. While analysing such cases CCI considered the provisions of the Act and found cases of bid-rigging, when the alleged conducts fell within the mandates of section 3(3) of the Competition Act, 2002.

24. Section 21 and 21 A of the Competition Act, 2002 do provide a framework which allows CCI and statutory authorities to refer a matter involving competition or otherwise to one another and delve into the issues involved. This process may be used by anti-corruption authority and CCI to handle issues of corrupt and anti-competitive conducts. Section 49 of the Competition Act, 2002 deals with competition Advocacy, which mandates CCI to undertake training and awareness programmes with the States, public sector enterprises, business associations, etc. and make them aware about impact and consequences of anti-competitive practices.

25. The provisions of the Act are so designed that decision making and investigation into anti-competitive conduct have become separate. To disallow any rent seeking the decision making process is posited into collegiums in contrast to one individual. The channel of communication of public/stakeholders with the Commission is very specific and it does not allow any process or procedure to grow up which may in turn lead to rent seeking opportunities. Thus it may be said that statutory provisions have guarded the Commission in a principled fort of decision making to keep decisions of the Commission free from any sort of biasness or influence which can in turn have unhealthy effect on the competition.