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FIGHTING CORRUPTION AND PROMOTING COMPETITION

Contribution from Zambia

-- Session I --

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

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FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Zambia *--

1. Competition and Corruption in Zambia: Introduction

1. Corruption is a reality and permeates every aspect of social, religious, political and cultural life. Corruption impacts societies in a multitude of ways. In the worst cases, it costs lives. Short of this, it costs people their freedom, health, or money. The effects of corruption can be divided into four main categories: political, economic, social, and environmental.

2. On the political front, corruption is a major obstacle to democracy and the rule of law. In a democratic system, offices and institutions lose their legitimacy when they are misused for private advantage. It erodes political legitimacy and citizens may see little point in following the rules and might result into political instability. It is extremely challenging to develop accountable political leadership in a corrupt climate. Economically, corruption depletes national wealth through sub-optimal allocation of national resources. Public resources may be invested in projects that will benefit corrupt stakeholders rather than maximizing the return on the investment.

3. Corruption also hinders the development of fair market structures and distorts competition, which in turn deters investment. Corruption corrodes the social fabric of society. It undermines people's trust in the political system, in its institutions and its leadership.

4. Environmental degradation is another consequence of corrupt systems. The lack of, or non-enforcement of, environmental regulations and legislation means that precious natural resources are carelessly exploited, and entire ecological systems are put at risk.

5. It is difficult to overstate the economic and social significance of corruption. Yet the lack of reliable and systematic data has kept corruption out of the research agenda of empirical economists. This report therefore attempts to make a case on how corruption affects competition generally with a special focus on Zambia.

2. Definition of corruption

6. Corruption is a multidimensional concept which takes various forms and types. The term corruption may include a wide range of illicit transactions such as the embezzlement of public funds or theft of public assets, non-monetary bribes such as favours, services and gifts. Various commentators have defined corruption differently largely reflecting geopolitical and sectoral and professional bias. According to Transparency International, corruption is; *“the abuse of entrusted power for private gain”*¹.

* Report submitted by Mr Emmanuel Chokwe, Research Analyst, Competition and Consumer Protection Commission of Zambia.

¹ http://www.transparency.org/cpi2011/in_detail

7. Corruption may further be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs. In most jurisdictions, a corrupt act is often but not necessarily illegal.

8. Other organizations such as the Swedish International Development Cooperation Agency (SIDA) define corruption as 'when institutions, organisations, companies or individuals profit inappropriately from their position in the operations and thereby cause damage or loss². Further, the World Bank defines corruption as simply “the abuse of public office for private gain³.”

9. Grand corruption consists of acts committed at a high level of government that distort policies or the central functioning of the state, enabling leaders to benefit at the expense of the public good. Petty corruption refers to everyday abuse of entrusted power by low- and mid-level officials in their interactions with ordinary citizens, who often are trying to access basic goods or services in places like hospitals, schools, police departments and other public and private agencies. Political corruption is a manipulation of policies, institutions and rules of procedure in the allocation of resources and financing by political decision makers, who abuse their position to sustain their power, status and wealth. Further, when corruption is so prevalent that it is part of the everyday structure of society rather than an exception, it is referred to as systemic corruption.

10. While corruption can be construed to generally mean dishonest or fraudulent conduct by those entrusted with power, it includes many activities including bribery, embezzlement, extortion and blackmail, abuse of discretion, favoritism, nepotism and clientelism and improper political contributions to influence political decisions, etc. Among these forms of corruption, bribery appears to be the most common form of corruption. It encompasses the improper use of gifts and favors in exchange for personal gain. The types of favors given are diverse and include money, gifts, sexual favors, company shares, entertainment, employment, political benefits etc.

11. More generally, corruption typically carries a connotation of impairment of integrity, virtue, or moral principle⁴.

12. Corruption has far reaching consequences or repercussions. While it is extremely difficult to measure the economic impact of corruption, the social costs of corruption, which are impossible to quantify can be staggering. This is because usually corruption leads to normative and qualitative social ills such as malaise, illiteracy, inadequate medical care etc. which are difficult to model and quantify. To this end, most conventional measures of corruption rely on perceptions of the general public which makes them at best estimates.

13. Despite the varied definitions of corruption, the overriding theme is the abuse of one's position, power or privilege for private gain. Corruption can occur in many different ways and economic sectors, whether it be public, private industry or even NGO's. This paper will focus on Government or Public sector corruption as it is one of the more dangerous forms of corruption as corruption of the governing body can lead to widespread undesirable effects.

3. Causes of Corruption

14. Inherent in the mainstream definitions of corruption is its underlying causes. The causes might differ across countries. However, whether corruption results from a need, a culture or simply from an

² <http://www.corruption-agenda.org/Default.aspx?ID=23469>

³ <http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm>

⁴ <http://www.merriam-webster.com/dictionary/corruption>

opportunity too tempting not to exploit, it influences the way we deal with it - or don't deal with it. According to the World Bank, the causes of corruption are always contextual, rooted in a country's policies, bureaucratic traditions, political development, and social history. However, corruption tends to flourish when institutions are weak and government policies generate economic rents. Such political systems are usually dominated by narrow vested interests and by international sources of corruption associated with major projects or equipment purchases.

15. The other main cause of corruption has to do with low and declining civil service salaries. When people in public service positions are on the margins of a living wage, they tend to make up for a small income through corruption. This is a prevalent cause of corruption in many low income countries. Related to this is dysfunctional government budgets, inadequate supplies and equipment and delays in the release of budget funds (including pay), among others.

16. In addition, weak anti-corruption laws and institutions can encourage corruption. In a society where corruption is widespread, those who resist it may feel disadvantaged which re-enforces a culture of corruption. This is compounded by weak institutions which fail to protect those who resist corruption.

17. Ultimately, the opportunity for corruption is greatest where the size of the rents under one's control is big, the discretion that official has in allocating those rents, and the accountability that official faces for his or her decisions. Therefore, poorly defined and inadequately disseminated rules and regulations on conduct and conflict of interest, and a weak mechanism to hold officials accountable accelerate the chances of corruption.

4. Corruption in Zambia

18. Like in many parts of the world, corruption in Zambia has attracted public attention and scrutiny especially in the last two decades following the collapse of the centralized economic system and the emergence of the free capitalist economy. There is a general perception by the general populace that public resources are not being managed in the best interest of the public. This feeling dates back to the early 1990's when the central Government embarked on the privatization of Government assets which some analysts believe were not handled in a transparent and accountable manner.

19. The Government of the republic of Zambia in 2001 rejuvenated the fight against corruption by re-energizing the Anti-Corruption Commission (ACC). Even though the ACC has been in existence since 1980 following the enactment of the Corrupt Practices Act No. 14 of 1980, it is only in the early 2000's that the fight against corruption gained momentum. Since 1980, the ACC Act has been revised several times including in 1996, 2010 and 2012 to make it relevant to the current situation. The ACC has wider powers including intelligence gathering and data analysis, investigation of corruption and other related crimes and prosecution of the accused once sufficient evidence of the offence is adduced.

20. The current Government has placed the fight against corruption on top of its agenda. We have observed decisive action being taken against erring senior public officers and the re-introduction of the "abuse of authority of office" clause in the ACC Act. The Anti-Corruption Act No 3 of 2012 prohibits promising, giving, receiving and obtaining of gratification in return for a favour. The Act defines gratification as any corrupt payment, whether in cash or in kind. The Act goes further to proscribe the misuse or abuse of public office for private or personal gain. Related to abuse of authority of office, a public officer who lives beyond one's past and present official emoluments must prove that the wealth they have acquired is within their past and present official emoluments. If they fail to provide an explanation of how they acquired such wealth or property, this may be deemed to have been corruptly or ill-gotten.

21. Despite the sound legal and institutional framework to fight corruption, corruption is still considered high in Zambia. Out of a total of 147 countries surveyed by transparency international in 2012, Zambia ranked 88. However, Zambia compares fairly well to other countries in Sub-Saharan Africa at number 13 out of 48 countries. The main area of concern as regards corruption in Zambia as indicated by Transparency International is the public service especially the police service.

5. Competition and Corruption in Zambia

5.1 The Link between Competition and Corruption

22. The most direct link between corruption and competition could be construed by considering the consequences of corruption and those of competition. Almost always, corruption negates the benefits of competition through sub-optimal allocation of resources. Whether, grand, political, petty or systemic, corruption tends to move resources away from where it is needed most to corrupt entities and persons.

23. The benefits of competition which include better quality goods and services, higher output and greater choice may be compromised by corrupt activities mainly grand corruption. Because it happens at a high level, grand corruption is highly influenced by the “ability to corrupt” and in most instances, the perpetrators are usually big corporates or entities connected to the corridors of power. When this happens, public contracts which are an important aspect of any economy are given to entities which are connected to the corrupt network at the expense of the best companies to deliver value to the public. The end result is lower quality goods and services, lower output and higher prices which impacts negatively on consumer welfare.

24. The other direct link between corruption and competition is the ability for corrupt entities to exclude other entities from competing in the relevant market. This can happen through excessive lobbying of persons and institutions in decision making positions. Corrupt authorities may then block competition in the relevant market by “excessive regulation” such as imposing unreasonable standards or other forms of non-tariff barriers to keep foreign and domestic competition at bay.

5.2 Corruption in Public Procurement in Zambia

25. When transactions especially in the public sector are characterized by corruption, competition is utterly distorted. For instance, instead of awarding a contract to the best bidder, the corrupt entity though not necessarily the best bidder will win the tender. The ultimate effect of this is that government and the general public will realize less economic value from that particular contract than if the best bidder was awarded. Further, because the entities most capable of corrupting the system tend to be big corporates, the smaller players tend to be excluded from the most lucrative contracts and therefore cannot compete on fair terms. This conduct cannot be separated from abuse of dominance and directly distorts competition and leads to misallocation of resources.

26. The example in box 1 below on corruption in the Indian pharmaceutical sector⁵ illustrates the possibility of using competition law to fight corruption in the public sector. Competition law could be used to deal with corruption at the supply side. As bid rigging is a horizontal agreement between competitors not to compete but to cooperate, the role of the procurement official is usually overlooked in cartel investigations of this nature. To effectively deal with corruption on the supply side, it is important to look at all parties involved in the supply chain including procurement officials.

⁵ CUTS International; Briefing Paper No. 5/2008: Dealing With Anti-Competitive Practices in the Indian Pharmaceuticals and the Health Delivery Sector; CUTS Centre For Competition, Investment & Economic Regulation, 2008.

27. Using data on corruption from two different sources Alberto Ades and Rafael Di Tella found that corruption was higher in countries where domestic firms were sheltered from foreign competition by natural or policy induced barriers to trade, with economies dominated by a few number of firms or where anti-trust regulations were not effective in preventing anti-competitive practices⁶. Further, countries where firms enjoy higher rents were found to have higher corruption levels. The study argued that the effect of competition on corruption is rather large such that almost a third of the corruption gap between Italy and Austria could be explained by Italy's lower exposure to foreign competition.

28. Despite this obvious link between excessive rents arising from market power and corruption, there is only weak empirical evidence that countries with markets dominated by a few firms have higher corruption⁷. However, there is sufficient evidence to suggest that countries where anti-trust laws are effective in checking anti-competitive practices also have lower rents and lower corruption⁸. This evidence offers credence to the theory that excessive rents arising from market power are likely to be spent on corruption in order to entrench and perpetuate the anti-competitive market structure.

29. The World Bank reports that macroeconomic stability may also be undermined by loss of government revenue and excessive spending through contracts that are awarded to high-cost bidders or without competitive tendering⁹. In transition economies and in many developing countries corruption may reduce revenue collection by driving firms or their most profitable activities out of the formal sector. The costs of macroeconomic instability are borne by all elements in society but especially by the poor.

5.3 *Corruption and Exclusionary Abuse of Dominance*

30. Corruption in general negates the basic principles of competition law as it generally leads to sub-optimal allocation of resources. Corruption is also intertwined with exclusionary abuse of market power. This is usually done through using informal means to lobby influential institutions and people to come up with policies and/or regulations which favour the dominant players at the expense of competition.

31. A result of such conduct is a system which tends to perpetuate the dominance of certain players at the expense of others while at the same time blocking any potential competition. The result of such restriction of competition may result in exclusionary conduct such as refusal to deal in or supply goods and services, and other forms of vertical restraints.

32. When such conduct happens, it perpetuates the dominance of corrupt elements at the expense of economic growth and general consumer welfare.

5.4 *Corruption and Exploitative Abuse of Dominance*

33. Some of the exploitative abuses of dominance include excessive pricing, imposing directly or indirectly unfair trading conditions, limiting or restricting production, and denying access to an essential facility. While a dominant firm can exercise exploitation without corruption, corruption can facilitate or make it easy for such exploitation to occur. This may range from the indifference of corrupt public officials and regulators to such conduct. In the Indian pharmaceutical industry, doctors connived with pharmacies or pharmaceutical companies to recommend to patients a particular drug though a better or less costly alternative was available. Pharmaceutical companies corrupted medical personnel with financial kickbacks who in turn secured customers (patients) for them See box 1 below.

⁶ Opcit.

⁷ Rents, competition and corruption, Alberto Ades and Rafael Di Tella; the American Economic Review, Volume 89, Issue 4 (September 1999).

⁸ Ibid.

⁹ www1.worldbank.org/publicsector/anticorrupt/cor02.htm

Box 1: Corruption and Exploitative Abuse in the Indian Pharmaceutical Industry¹⁰

CUTS International conducted a study in 2005-06 on “Options for Using Competition Law/ Policy Tools in Dealing with Anti-competitive Practices in Pharmaceuticals and the Health Delivery System”, which was supported by the World Health Organisation (WHO) and the Ministry of Health and Family Welfare, Government of India. The report noted that the availability of supply, price, quality, ability to pay and access to proper and affordable consultations were adversely affected by corruption among others. Patients are guided by the advice of doctors and pharmacists, and lack the freedom to choose which drug to consume. The report found that drug companies manipulate and exploited this influence, more often than not. The significant role assumed by the doctors and pharmacists in influencing drug sales resulted in patients being misled into purchasing more expensive medicines, or prescribing irrational (or combinations of) drugs, which may lead to medical complications, sometimes even causing death. Corruption in the form of kickbacks to doctors and pharmacists by drug companies perpetuated this conduct. In particular, Novartis, a company that has a large market share in India had been accused of fuelling the misdiagnosis of Attention Deficit Disorder (ADD) through its close association with psychiatric associations and its presentations at their meetings, and conspiring to carve a niche in the market for Ritalin, the drug for ADD. Doctors also received commission for referring the patient for further treatment to a particular diagnostic centre, pharmacist, or hospital even though it was not required. Further, some hospitals entered into agreements with drug companies to be supplied with drugs at above the market price for a kickback.

5.5 Corruption and Cartelistic Tendencies

34. Cartel activity thrives in a corrupt system. Many cartel conduct cases especially in sectors such as public procurement rely on corrupt public officials. Corrupt public officials may tolerate illegal activities including cartels. In some countries, there exists what is called “legal cartels”. These legal cartels are officially sanctioned by governments for various reasons bordering on serving some socio-economic goals. A point in case is the legal cement cartel which existed in South Africa from the 1940s up to 1996 when it was officially disbanded and became subject to that country’s competition law.

35. In a corrupt system, such arrangements may be abused and allowed to continue beyond their relevance by corrupt public officials to the detriment of consumers.

6. Cross Cutting Issues

6.1 Corruption and Investment

36. One of the direct consequences of corruption especially in developing countries is its negative impact on Foreign Direct Investment (FDI). For most foreign firms, corruption is a cost of doing business to be recouped from revenues. FDI may still flow to countries in which corruption is systemic but only if bribery is affordable and the results are predictable. Where corruption is large and systemic, foreign investors may shun the country altogether as it makes the investment climate unpredictable.

37. In other cases, investment may be concentrated in extractive industries in which operations can be enclaved, or in light manufacturing or trading operations that can be relocated if corruption costs become unbearable. If the costs become too high or unpredictable, foreign firms will disengage unless global marketing or sourcing considerations require them to maintain a presence in that country. High levels of corruption add to the risk of a country being marginalized in the international economy.

¹⁰ Briefing paper No. 5/2008: Dealing With Anti-Competitive Practices in the Indian Pharmaceuticals and the Health Delivery Sector; CUTS Centre for Competition, Investment & Economic Regulation.

6.2 *Corruption and Environmental Degradation*

38. There are huge rents to be earned from activities such as logging in tropical rain forests, where permits can be obtained corruptly or where inspectors can be bribed. Many countries have enacted laws to protect the environment which is under threat such as rain forests and have created special agencies to enforce these laws. However, there is often a disconnect between policy and its implementation. Complying with environmental regulations imposes on firms costs that can be avoided by bribery. The environmental costs of corruption may take the form of ground water and air pollution, soil erosion, or climate change, and can be global and intergenerational in their reach. Through corrupt practices, the environment may be endangered.

6.3 *Corruption and the Poor*

39. Corruption exacerbates the socio-economic marginalization of the poor in society. When corruption results in shoddy public services, the poor lack the resources to pursue "exit" options such as private schooling, health care, or power generation. Furthermore, anecdotal and survey evidence reveal the cost of petty corruption to the poor. When access to public goods and services requires a bribe, the poor may be excluded¹¹. Given their lack of social and political influence, the poor may even be asked to pay more than people with higher incomes¹². Where there is corruption, the poor suffer.

6.4 *Corruption and Development*

40. Corruption leads governments to intervene where they need not, and it undermines their ability to enact and implement policies in areas in which government intervention is clearly needed - whether environmental regulation, health and safety regulation, social safety nets, or contract enforcement. The combined effect of this is that the development process is retarded. Corruption is bad for development.

7. *Conclusion*

41. Corruption is pervasive and affects every aspect of human life. In many cases, it benefits the corrupt few and negatively impacts on consumer welfare of the masses. There is therefore an urgent need to step up efforts to fight corruption in all its forms and manifestations. Where corrupt practices borders on anti-competitive conduct and violation of competition law, it is important that it is fought using the provisions of competition law.

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