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**LATIN AMERICAN COMPETITION FORUM**

**Session III - Improving Effective Public Procurement: Fighting Collusion and Corruption**

**Contribution from Mexico**

**18-19 September 2012, Santo Domingo, Dominican Republic**

*The attached document from Mexico is circulated to the Latin American Competition Forum FOR DISCUSSION under Session III of its forthcoming meeting to be held on 18-19 September 2012 in Santo Domingo, Dominican Republic.*

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## LATIN AMERICAN COMPETITION FORUM

-- 18-19 September 2012, Santo Domingo (Dominican Republic) --

### Session III – Improving effective public procurement: fighting collusion and corruption

#### -- CONTRIBUTION FROM MEXICO --

1. This note summarizes Mexico's experience in fighting collusion in public procurement.

2. Section I describes the importance of public procurement in Mexico. Section II identifies the synergies between policies to fight corruption and those aimed at fighting bid rigging. Section III describes Mexico's Federal Competition Commission's (hereinafter Commission or CFC for its acronym in Spanish) efforts to introduce more competition in public procurement. Finally, section IV provides an overview of the Commission's recent advocacy work in this field.

#### I. Size and policy objectives

3. Public sector activities play a substantial role in the Mexican economy. In 2008, for example, they accounted for 18.4% of GDP with the following distribution among government entities: public enterprises, 8.7%; state and municipal governments, 5.5%; federal government, 2.9%; and social security, 1.3%.<sup>1</sup>

4. In 2009, according to the *Instituto Mexicano para la Competitividad* ('IMCO' is a NGO aimed at strengthening competitiveness in Mexico through public policies initiatives), public procurement accounted for approximately 6.8% of the GDP.<sup>2</sup> Public enterprises such as Pemex (state oil monopoly), CFE (electricity monopoly), IMSS (social security services to private sector employees) and ISSSTE (social security services to federal government employees) represent almost half of the total value of public procurement contracts.<sup>3</sup>

<sup>1</sup> OCDE, Policy Roundtable, Collusion and Corruption in Public Procurement, 2010, page 246.

<sup>2</sup> IMCO, Análisis de la normatividad y las prácticas de compras públicas a nivel estatal: Zacatecas, Forthcoming, September 2012, page 1 (footnote 8). Soon available at [www.imco.org.mx](http://www.imco.org.mx).

<sup>3</sup> *Ibid.*

5. The policy objectives governing public procurement in Mexico are included in Article 134 of the Mexican Constitution, which states that public procurement shall assure the best available terms and conditions for the State. The Law of Public Sector Acquisitions, Leasing and Services (Acquisition Law) and the Law of Public Works and Related Services (Public Work Law) implement Article 134 and establish other policy objectives in public procurement such as efficiency, efficacy, transparency, economy, and honesty.<sup>4</sup>

## II. Synergies between policies to fight corruption and collusion

6. Corruption and collusion in public procurement are sometimes intertwined. Empirical evidence shows that corruption and collusion can occur in tandem, and certainly, there is a direct relationship between the level of corruption and the risk of collusion in a given market.<sup>5</sup> For instance, where corruption occurs in a public contract, collusion between bidders –in the form of compensatory payments or the granting of subcontracts – may be necessary to ensure that losing bidders do not expose the illegal conduct to the public authorities. Conversely, bidders operating in a solid competitive market will likely restrain from offering bribes to the authority given the risk of failure (i.e. the bribing company might be detected by a competitor and reported to the anticorruption authorities or the public official might refuse the offer because his/her decision will be strongly scrutinized by other bidders).<sup>6</sup>

7. Both collusion and corruption are mutually reinforcing, thus, reducing the likelihood of one offence will also decrease the risk of the other.<sup>7</sup> Moreover, policy tools intended to fight corruption in public procurement may also help in defeating collusion. For instance, requesting electronic bids rather than sealed bids or establishing different authorities to monitor the procurement process are actions with clear positive effects in reducing both corruption and collusion.

8. The CFC is not empowered to investigate, prosecute or initiate any case based on corruption grounds. The authorities empowered to enforce the recently adopted Public Procurement Anti-corruption Act (Anti-corruption Act) are those set forth in Articles 4 and 5 thereof.<sup>8</sup> The Ministry of Public Administration (SFP for its acronym in Spanish) is one of the main domestic enforcers in corruption matters. Furthermore, the SFP is also the authority entitled to design the public procurement rules and to monitor the adequate implementation of these rules. For this reason, it is clear to the Commission that the actions taken to fight bid rigging must include the strengthening of the collaboration with the SFP. First, because as mentioned above, less corruption will render more competition in the market and second, because better procurement rules will decrease the risk of collusion.

## III. CFC actions to fight bid rigging

9. Bid rigging (or collusive tendering) occurs when businesses, that would otherwise be expected to compete, secretly conspire to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process.<sup>9</sup> As noted in the OECD Guidelines for fighting

<sup>4</sup> Ley de Adquisiciones, Arrendamientos y servicios del Sector Público, DOF 16-01-2012, Article 24 and Ley de Obras Públicas y Servicios Relacionados con las Mismas, DOF 09-04-2012, Article 24, para. 1

<sup>5</sup> Compte O., A. Lambert-Mogiliansky and T. Verdier, *Corruption and Competition in Public Markets Auctions*, CEPR discussion paper n 2434, 2000

<sup>6</sup> OCDE Policy Roundtables, Collusion and Corruption in Public Procurement, 2010, page.10

<sup>7</sup> *Ibid.*

<sup>8</sup> Ley Federal Anti-corrupción en Contrataciones Públicas, DOF 11-06-2012.

<sup>9</sup> OECD Guidelines for fighting bid rigging in public procurement, Helping governments to obtain best value for money, page 1

bid rigging in public procurement (OECD Guidelines), factors which may encourage conspiracies or collusion between competitors in public tenders include:<sup>10</sup> small number of companies in the market, little or no entry, unlawful use of industry associations, repetitive bidding, homogenous products or services, few substitutes and little technological change.

10. CFC's actions to fight bid rigging rested on two pillars: (i) enforcement actions and (ii) advocacy work. As regards to the first pillar, enforcement, the CFC has sought to send the clear signal to the market that engaging in bid rigging activities will have an important cost for the infringers.

11. In 2000, the CFC investigated and sanctioned three firms with more than MXN 15 millions for bid rigging in the market of radiographic materials.<sup>11</sup> The CFC identified a collusive agreement among the three bidders who were the only participants in the market (Kodak, Juama y GPP). After these findings, IMSS opened procurement of these materials to international competition, which resulted in a dramatic reduction in prices.

12. In 2006, the IMSS requested the CFC to analyze a set of bids because it had some concerns about the often high or similar prices presented by some bidders and the apparent low competition levels among them. Following this request, the CFC opened an investigation against several pharmaceutical companies for possible anti-competitive practices in the public procurement processes of IMSS.<sup>12</sup> In January 2010, the six pharmaceutical companies involved were fined MXN 130 million (approximately USD 10 million), the maximum amount allowed at that time in Mexico. The CFC's decision was endorsed by the courts.

13. As regards to the second pillar, advocacy work, the CFC is seeking to amend public procurement rules and federal rules to enhance competitive processes and to reduce companies' incentives to engage in collusive conducts.

14. The CFC's advocacy work gained momentum in 2006 when IMSS required the Commission to carry out an analysis of its procurement regulation and practice. The CFC identified that the legal framework and practice facilitated market sharing and bid rigging throughout the Mexican territory. Thus, the CFC recommended three actions to the IMSS in order to reduce the risk of collusion in its future procurements: (i) to consolidate its purchases, (ii) to limit the awarding of the same contract to multiple contractors and (iii) to reduce reference prices (these prices act as an upper and lower bound above and below which no bid can be accepted).

15. Few years later, in 2011, as a consequence of the successful results obtained with the implementation of the CFC's recommendations, the IMSS committed to convey a more in-depth analysis of its procurement system. To this end, IMSS signed an agreement with the OCDE and the CFC, the first in the world of this kind, whereby IMSS would align its procurement practices to the best international practices foreseen in the OECD Guidelines for fighting bid rigging in public procurement.<sup>13</sup> For this purpose, the OECD, together with the CFC, elaborated a report which: a) identified areas for further

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<sup>10</sup> *Ibid*, pages 2-3

<sup>11</sup> *X-Ray Materials* (CFC file: DE-57-2000)

<sup>12</sup> *Drugs Procured by IMSS* (CFC file: OI-003-2006). In January 2010 six pharmaceutical companies were fined MXN 130 million (approximately USD 10 million), the maximum amount allowed at that time in Mexico.

<sup>13</sup> OECD, *Fighting bid rigging in Public Procurement in Mexico*, 2011

improvement in the Acquisitions Law and in IMSS's practices, and b) advanced a set of recommendations that would help IMSS to improve its procurement processes.<sup>14</sup>

16. These recommendations included, among others, to further consolidate IMSS's purchases, to limit the use of the exceptions to public tenders, and to open up participation as fully as possible.

17. The IMSS also implemented this second set of recommendations made by the OECD and the CFC resulting in further cost savings for the IMSS. The IMSS calculated that the cumulative savings for the period 2006-2011 due to the changes in the public procurement system accounted for MXN 58,692 million (aprox. USD 4,460 million).<sup>15</sup>

#### IV. CFC's advocacy work with other entities

18. IMSS's impressive savings have encouraged other public entities to seek for technical assistance to improve their bidding processes. For example, CFE (currently the second largest public buyer of goods and services in Mexico<sup>16</sup>) has requested an in-depth analysis of its current procurement system with the purpose of reducing the risk of collusion in future purchases.<sup>17</sup> Similarly, ISSSTE (the second largest provider of health services in Mexico) initiated on June 4, 2012 a project aiming to achieve similar results as those obtained by IMSS.

19. The CFC has also begun several projects across the country advocating for an improvement in the states' public procurement legislations (seeking conformity with the OECD Guidelines). In this regard, the OECD with the support of the CFC, prepared a report analyzing the procurement legislation, regulation and practice of the State of Mexico.<sup>18</sup>

20. Furthermore, IMCO with the advice of the CFC and the OECD developed a ranking to assess the quality of Mexico's 32 states public procurement legislation.<sup>19</sup> Based on the results of the study, IMCO is elaborating reports to recommend improvements to the procurement legislation and practices of the states of Guerrero<sup>20</sup> and Zacatecas<sup>21</sup>. Meanwhile, the CFC has been training procurement public officials in these states on detection and prevention of collusion. In addition, IMCO is developing and will release in 2012 a Model Law on Public Procurement for Mexican States.

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<sup>14</sup> *Ibid.*

<sup>15</sup> Informe al ejecutivo federal y al congreso de la unión sobre la situación financiera y los riesgos del Instituto Mexicano del Seguro Social 2011-2012. Available at <http://www.imss.gob.mx/estadisticas/Documents/20112012/informecompleto.pdf>

<sup>16</sup> See *supra* note 13, page 9

<sup>17</sup> Similarly, in 2011 CFE signed an agreement with the OCDE to elaborate an integrity report enabling CFE to combat corruption in public procurements. For more information see OCDE Review of the Procurement Policies and Practices of the Mexican Energy Sector (forthcoming). Soon available at [www.oecd.org](http://www.oecd.org)

<sup>18</sup> The report for the State of Mexico will be made public in October 2012

<sup>19</sup> IMCO, Competencia en las compras públicas: Evaluación de la calidad normativa estatal en México, September 2011. Available at [www.imco.org.mx](http://www.imco.org.mx)

<sup>20</sup> IMCO, Análisis de la normatividad y las prácticas de compras públicas a nivel estatal: Guerrero, Forthcoming, September 2012. Soon available at [www.imco.org.mx](http://www.imco.org.mx)

<sup>21</sup> IMCO, Análisis de la normatividad y las prácticas de compras públicas a nivel estatal: Zacatecas, Forthcoming, September 2012, page 1 (footnote 8). Soon available at [www.imco.org.mx](http://www.imco.org.mx)

21. Lastly, the CFC is currently working on a non-binding opinion that will include recommendations aimed at improving the Federal Acquisitions Law. These recommendations will seek, among other things, to increase foreign suppliers' participation, limit the use of joint bids, require a "Certificate of Independent Bid Determination," redefine reasonable prices, restrict significantly the awarding of a contract to multiple suppliers, and allow for higher fines for non or partial fulfillment of a contract.