



Fighting Cartels in Public Procurement

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Introduction

Governments devote a large share of taxpayers' money to public procurement – purchasing goods and services from road building to school textbooks. But how can they be sure that they are getting good value for money, and that companies seeking public contracts are not conspiring to undermine the principle of competitive bidding?

One key area is bid-rigging where companies illegally agree on a price for a service or contract or agree not to bid at a tender. So governments should focus on fighting bid-rigging in their public procurement systems – a significant portion of domestic cartel operations involve bid-rigging in auction or procurement procedures. Frequently, the procurement authority is best placed to detect signs of unlawful bidding arrangements, as it has good knowledge of the relevant industry sector and it can observe patterns in bidding processes that could indicate unlawful collusion.

At the same time, competition authorities should expand their programmes to alert governments to the dangers of cartels directed against them, and work more extensively with procurement officials in an effort to fight bid-rigging more effectively. Procurement authorities can influence how bidding procedures are organised to make it more difficult for companies to form cartels. However, programmes to systematically educate procurement officials exist in only a few OECD countries. This suggests that in many countries procurement authorities and officials are not yet sufficiently aware of the danger of cartels among firms participating in bidding procedures and of the important role they can play in preventing and detecting cartels. ■

Why is public procurement so important?

Public procurement is the purchase of goods or services by the public sector and it generally accounts for a large share of public expenditure in a domestic economy. Public procurement is a key economic activity of governments, accounting for an estimated 15% of gross domestic product (GDP) worldwide on average. The figure is even higher in some OECD countries where public procurement expenditure is estimated at approximately 20% of GDP. Through its public procurement policy, the public sector can affect the structure of the market and the incentives of firms to compete more or less fiercely in the long run. Procurement policy therefore may be used to shape the longer-term effects on competition in an industry sector.

The primary objective of an effective procurement policy is to promote efficiency – in other words, to ensure that the supplier offering the lowest price or, more generally, the best “value for money” is awarded the contract. Effective public procurement avoids mismanagement and waste of public funds. It is therefore important that the procurement process is not affected by practices such as collusion, bid-rigging, fraud and corruption. Anticompetitive conduct affecting the outcome of the procurement process is a particularly pernicious violation of competition law. Through bid-rigging practices, the price paid by public administration for goods or services is artificially raised, forcing the public sector to pay above market rates. These practices have a direct and immediate impact on public expenditure and therefore on taxpayers’ resources. ■

Why does public procurement increase risks of collusion?

Collusion to fix prices can of course emerge in ordinary markets as well as in public procurement bids. But the formal rules governing public procurement can make communication among rival companies easier, promoting collusion among bidders. While collusion can emerge in both procurement and ordinary markets, procurement regulations may facilitate collusive arrangements.

The competition concerns arising from public procurement are largely the same concerns that can arise in an ordinary market context: collusive agreements between bidders during the auction process or across various auctions. But the government has limited strategic options in dealing with the threat of collusion compared with a private purchaser. Whereas a private purchaser can choose his purchasing strategy flexibly, the public sector is subject to transparency requirements and generally is constrained by legislation and detailed administrative regulations and procedures on public procurement. These rules are set to avoid any abuse of discretion by the public sector. However, full transparency of the procurement process and its outcome can promote collusion. Disclosing information such as the identity of the bidders and the terms and conditions of each bid allows competitors to detect deviations from a collusive agreement, punish those firms and better co-ordinate future tenders.

The lack of flexibility which may result from strict regulation of the procurement process limits the opportunities for the public purchaser to react strategically when confronted with unlawful co-operation among potential bidders seeking to increase profits. It is therefore important that the legislative and regulatory framework for public procurement be designed to allow sufficient flexibility on the purchasing side. Introducing new and different procurement procedures such as reverse auctions or direct negotiations, or allowing the procurement entity to adapt the standard procurement procedures according to the market situation with which it is confronted, may achieve positive results. ■

How to reduce these risks effectively?

The risks of collusion in public procurement can be reduced by careful consideration of the various features of the auction process and their impact on the likelihood of collusion. Designing auction and procurement tenders with the need to prevent collusion in mind may significantly contribute to the fight against anticompetitive behaviour, as it allows the creation of an environment where the bidders' ability and incentives to reach collusive arrangements are significantly reduced, if not eliminated.

There are numerous different forms of tenders that might be adopted in the procurement context, but not all bidding models are equal from the point of view of competition. Where there are enough firms in the procurement market to sustain reasonable competition, efficient procurement outcomes may be achieved through a simple auction or tender process (either sealed or open bid). When there are not enough firms to sustain competition, more sophisticated arrangements may be necessary to achieve an efficient outcome. The choice of the most suitable bidding model given the circumstances of the procurement is therefore the starting point of any attempt to prevent collusion in public procurement.

Open tenders, for example, are more susceptible to collusion than sealed-bid tenders. Open tenders allow members of a cartel to communicate during the course of the tender and therefore make it easier for them to reach a collusive understanding at the auction (this is known as "in-auction collusion"). In a sealed-bid tender, where each bidder simultaneously makes a single "best and final" offer, collusion is much harder, not least because it requires communication in advance that is not needed at an open tender. From the perspective of encouraging more companies to come forward to bid for contracts, sealed-bid tenders have the merit of making the selection much more uncertain than in an open tender. Sealed-bid tenders encourage participation of "weaker" or smaller participants since they have a chance of winning if the highest-value bidder is seeking a bargain and does not bid the maximum amount it would have in an open tender. ■

Can the design of tenders make the procurement process more effective?

The efficiency of the procurement process not only depends upon the bidding model adopted but also on how the tender process is designed and carried out. The design of the precise features of the competitive bidding process can also have a strong influence on the efficiency of the outcome.

While auction design is not “one size fits all”, the risk of collusion can be reduced when the procurement agency ensures that the procurement activity is designed and carried out to achieve three main objectives: 1) reducing barriers to entry and increasing bidders’ participation; 2) reducing procurement-process transparency and the flows of competitively sensitive information; and 3) reducing the frequency of procurement opportunities.

Increasing the opportunity for potential bidders to participate in a tender can make the bidding process more efficient and reduce the likelihood of collusion. One reason is that if only a small number of bidders are able to take part in a tender, it is easier and cheaper to organize a sustainable cartel. In procurement markets, barriers to entry can be lowered by ensuring that criteria for taking part in a tender are not unnecessarily restrictive and by reducing the costs of preparing a bid, for example by using electronic bidding systems.

Collusion can be established and sustained if firms have complete information on the main variables of competition. A high degree of transparency over the procurement process may in fact facilitate collusion by making it easier for members of a cartel to detect and punish deviations from a cartel agreement. Bid-rigging can be more difficult if the bidders are not easily identifiable, so procurement officials should consider keeping the identities of the bidders confidential, perhaps referring only to bidder numbers or allowing bids to be telephoned, mailed or e-mailed in, rather than requiring bidders to present themselves in person to register their bids at a designated time and place where they can all see who else is there.

Sustainable collusion is only possible if the same firms regularly meet and interact in the market place. Only in this case are firms capable of adapting their respective strategies by acting and reacting to competitors’ strategies. Collusion is therefore easier if bidders meet each other repeatedly in a number of procurement opportunities. Reducing the number of such opportunities therefore may facilitate competition. This might be achieved, for example, by holding fewer and larger tenders. If the distance in time between one tender and the next is sufficiently long, the individual firms have less reason to fear retaliation in the future for undercutting the cartel price today. By the same token, holding tenders at short and regular time intervals may favour collusion.

When designing public tenders, procurement officials should consider limiting joint bids and sub-contracting while at the same time imposing a reserve price. Depending on the facts of each procurement activity, these considerations may promote efficient procurement outcomes.

Some jurisdictions allow joint bidding by firms in the same market only if bidding is costly or if a minimum size of business is necessary to carry out the contract. In these circumstances, joint bidding is a way to enable smaller firms to participate in larger tenders, from which they would otherwise be excluded. However, a bidding consortium should not be permitted if each firm in the consortium has the economic, financial and technical capabilities to fulfil the contract on its own.

If possible, bids should be free of sub-contracting. Allowing the winning bidder to enter into subcontracting arrangements has a potentially important effect on the likelihood of bid-rigging. In particular, the mechanisms of the cartel may be such that bidders who agree to bid higher than the designated winner's price or not to participate at all might be compensated by being awarded a subcontract by the winning bidder.

Imposing an aggressive but credible reserve price – the maximum price above which the procurement tender is not awarded – may reduce collusion as it reduces the illegal gains. In addition, reserve prices can reduce the number of rounds in an open auction, thereby reducing the opportunity for signalling among cartel conspirators.

The use of independent bid certificates in the procurement process may also be effective. ■

What role for competition authorities in public procurement?

Reducing collusion in public procurement requires strict enforcement of competition laws and the education of public procurement agencies at all levels of government to help them design efficient procurement processes and detect collusion.

Collusion in public procurement may be reduced through strict, effective competition law enforcement. Many jurisdictions have specific prohibitions in their competition laws forbidding bid-rigging or considering bid-rigging as a *per se* violation of the competition rules. Other countries simply base their enforcement practice against bid-rigging on the general antitrust laws against anti-competitive agreements.

Many competition authorities are also involved in advocacy efforts to increase awareness of the risks of bid-rigging in procurement tenders. There are many examples of educational programs to this end. Some authorities have regular bid-rigging educational programs for procurement agencies; others organise *ad hoc* seminars and training

courses. This education effort includes documentation describing collusion and bid-rigging, the forms it can take and how to detect it (see Box 1). ■

How to detect collusion during the tender process?

There are a number of signs which can help detect bid-rigging. Competition authorities can help procurement agencies to identify these signs at an early stage of the procurement process, increasing the effectiveness of competition law enforcement.

Various industry or product characteristics have been found to help collusion in a procurement market: concentrated market structure where there are only a few firms in a particular sector; a high level of market transparency so it is easy to see what competitors are doing; high entry barriers making it difficult for new or smaller firms to bid for contracts; limited residual competition, where there are only a handful of potential alternative suppliers; identical or simple products or services; limited buyer power; stable demand and supply conditions; opportunities for repeated interaction between market participants and similar firm characteristics; and active trade associations. While these factors may make it easier to engage in bid-rigging, not all of them need to be present for collusion to be likely.

However, bid-rigging, price fixing, and other collusion can be very difficult to detect; since these activities are unlawful, those involved in such agreements will do their utmost to keep them secret. Suspicions may be aroused by unusual bidding or pricing patterns or something a vendor says or does. A number of countries, such as Canada, Switzerland, Sweden and the US have developed check lists to help procurement agencies to spot instances of possible collusion. These check lists contain indications of potentially collusive conduct, but they are not conclusive.

Box 1.
RAISING AWARENESS OF BID-RIGGING RISKS

Outreach programmes by competition authorities to help increase awareness of bid-rigging risks have proved extremely useful for a number of reasons:

- they help competition investigators and public procurement officials to develop closer working relationships;
- they help educate procurement officials about what they should look for in order to detect bid-rigging through actual examples of bidding patterns and conduct which may indicate that bid-rigging is occurring;
- they train procurement officials to collect evidence that can be used to prosecute bid-rigging conduct more effectively;
- they help educate public procurement officials and government investigators about the cost of bid-rigging to the government and ultimately to taxpayers; and, finally,
- they warn procurement officials not to participate in bid-rigging and other illegal conduct which undermines competition in procurement tenders.

Outreach to industries which frequently respond to tenders can also be an effective way of raising awareness.

For example, the fact that the level of bids is too high compared to the estimate should not be viewed by itself as evidence of collusion as it may simply reflect an incorrect estimate. Thus, these indicators should simply alert agencies that further investigation is required to determine whether collusion exists or whether there are other plausible explanations for the factors in question.

Another way to detect and prevent bid-rigging in public procurement is to monitor bidding activities and to perform quantitative analyses on the bid data. This can help procurement agencies, with the support of competition authorities, to identify up-front those sectors where infringements of antitrust rules are more likely. In order to do so, however, it is crucial to examine the bids that have been submitted in the past to determine if the patterns are consistent with a fully competitive process. Such analyses would allow procurement and competition agencies to maximise their efforts, optimising tender design in those industry sectors which are at risk and allocating law enforcement resources to detect collusion in those sensitive sectors. ■

For further information

For more information about this *Policy Brief* and the OECD report on “Public Procurement, The Role of Competition Authorities in Promoting Competition” please contact: Antonio Capobianco, tel.: +33 1 45 24 98 08, e-mail: Antonio.Capobianco@oecd.org.

For more information on the OECD’s work on competition policy, please visit: www.oecd.org/competition or contact dafcomp.contact@oecd.org



For further reading

OECD (2007), **Journal of Competition Law and Policy**,
ISSN 1560-7771, Subscription (3 issues per year), € 152.

OECD (2003), **Hard Core Cartels: Recent Progress and Challenges Ahead**,
ISBN 978-92-64-10124-1, 64 pages, € 25.

OECD (2002), **Fighting Hard Core Cartels: Harm, Effective Sanctions and
Leniency Programmes**, ISBN 978-92-64-19735-0, 85 pages, € 36.

**Recommendation of the Council Concerning Effective Action against Hard
Core Cartels** (1998).

The following are available for free download at: www.oecd.org/competition.

OECD (2005), **Best Practices for the Formal Exchange of Information between
Competition Authorities in Hard Core Cartel Investigations**.

OECD (2005), **Hard Core Cartels: Third Report on the Implementation
of the 1998 Recommendation**.

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