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COLLUSION AND COLLUSION IN PUBLIC PROCUREMENT

Contribution from the Slovak Republic

-- Session V --

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COLLUSION AND COLLUSION IN PUBLIC PROCUREMENT

-- Slovak Republic --

1. Size and policy objectives

1.1. *What fraction of your economy does public procurement account for? What are the principle policy objectives of public procurement?*

1. The aim of public procurement is to simulate competition, where it could be weakened – in situations where public sector is a buyer. Within public procurement to which private and public sector participate, the procurer does not decide on its own, but on public funds and discretion power exists. It may cause that the best bid is not chosen, but it will be affected by corruption, or procurer will be not sensitive to the fact, that through collusion a price for state may increase. Considering the fact that state – *principal* buys through *agents* – procurers from private firms, this creates known *agent-principal* problems, area for corruption on procurers' side and collusive incentives on undertakings' side, among others.

2. Corruption

2.1. *What is the cost of corruption?*

2. Apart from negative impacts on ethics and morals of the society corruption causes the following problems:

- Decisions, made in public interest, are affected by internalities (by private incentives of people who are authorised to adopt decisions in public interest). Subsequently, it causes that there is interest to maintain or to extend scope of activities, where it is decided on “other people's money”, there is pressure on extension of regulations, redistribution. Labyrinth of various regulation interventions together with discretion power in decision making creates area for corruption. Higher involvement of the state in economy has at the same time a potential to distort competition.¹
- If it is decided on public funds on a basis of private motives, sources are not allocated optimally and competition is distorted. Inefficient transfers may occur; sources are shifted from efficient subjects and activities to advantage of inefficient ones. Allocation efficiency of economy is worsening. It means that the best entrepreneurs are not supported, conditions for their increase are not created, but advantages are given to entrepreneurs, which have the strongest “lobby”.

¹ Tanzi (1998) states many examples, where opportunity for corruption is connected with excessive regulation. For example he states that the harder is to understand tax laws the easier is to corrupt, because there is higher discretion power for decision makers. Similarly, Zemanovicova and collective (1998) introduces many regulation barriers in conditions of transition economies, which distort competition conditions.

Undertakings are focused on rent seeking, not on profit seeking. Thus, not the creation of wealth but its redistribution is supported. It results in decrease of all wealth of a country.²

- Corruption, non-transparent rules cause higher transactions costs. The environment is favourable for corruption if rules are unclear, ambiguous and complicated. This, at the same time, creates barriers for undertakings in the form of transactions costs. Analysis of licenses, permits, concessions, subsidies and grants shows that rules for their granting are not defined clearly. This provides discretion power in decision making on one hand and creates uncertainty for undertakings on other hand. Moreover, if rules are unclear, uncertainty induces undertakings to gain advantage and certainty by bribe.
- Uncertainty of the manner how rules will be applied increases investment risk, creates barriers to entry market. If undertakings are not sure that rules and acts are respected and enforced or if they are coming to such an environment where the run of the business need giving bribes, their investment risk increases. Undertakings consider high degree of corruption as a barrier to entry to the market in the given country.
- Corruption causes that economy does not use its potential and thus consumer gets less than he/she could get at given level of sources. Prices increase and on other hand quality and availability of goods and services decrease in environment of corruption. For example an undertaking which gets public contract by bribe, includes bribe into the price paid by consumer. Estimates show that it may come to surcharge of public contracts up to 30% in environment of corruption.
- Corruption may affect extent and structure of public expenses. For example according to some studies³ corruption tends to increase extent of public investments, to reduce their efficiency and affects structure of public expenses.
- Apart from economic and social consequences it is necessary to consider also wider political impacts. In environment of corruption citizen loses confidence in state, rule of law; equality before law as well as democracy itself are questioned and moral decreases. Corruption also causes inequality of citizens according to the fact whether they have sources for bribe or not, what separates citizens into ones which have access for example to education, quality health services. However, also into triable and non-punishable according to the fact whether they can ensure “favourable” settlement of legal process by bribe for themselves.

2.2. *What factors facilitate corruption? Do some factors appear to be more important than others?*

3. According to R. Klitgaard corruption formula may be framed:

$$\text{Corruption} = \text{Monopoly} + \text{Discretion power} - \text{Transparency.}$$

4. Corruption flourishes in situation where profit from corruption is high and risk of detection is low. It relates to formal and informal rules.

5. As for formal rules an area for corruption arises, if there is imbalance between supply and demand, there is monopoly. Also if rules do not exist, if they are unclear or unpredictable. Those facts

² Many researches (for example Wei, 2001) indicate that negative correlation between extension of corruption and economic increase exists.

³ Tanzi and Davoodi (1997).

allow discretion power and subjectivism. Also if the rules are not enforced, if legislation in force and law enforcement cause that risk of detection and withstanding of consequences is negligible or low comparing to benefit. Not only repression is important, but also prevention, thus such system changes, which restrict area for corruption.

6. Also informal rules are very important, because softer rules, moral system and acceptance of ethics and moral values also act as regulator of conduct. If tolerance of citizens for corruption is high, effective pressure on change does not exist. Public pressure may create political will and may lead to system changes, which restrict area for corruption and ensure both detection corruption and effective punishment. Experience shows that corruption prospers less in the countries with the active civil society.⁴ Creation of informal rules is long-lasting process, which is affected by historic, cultural, economic conditions. Informal rules unlike formal rules cannot be changed quickly; they have their own natural inertia.

2.3. *How do transparency programs help fight corruption? What other policies help fight corruption? What methods and techniques seem particularly effective in your jurisdiction?*

7. Transparency is the one of the most effective and the cheapest tools of restriction of corruption. In the Slovakia context, for example adoption of the Act on Free Access to Information in the year 2000 has significantly changed system of public administration, which had been closed until then.

8. To restrict corruption the changes in prevention area are required:

- Transparency of rules, processes, institutions, funding of political parties;
- As well as reforms for example in health care, education, because corruption prospers in imbalance between supply and demand.

9. Functioning control and repression systems are also important, namely control systems, police, prosecutor's office and courts.

10. Within informal rules it is important to increase awareness of citizens to corruption issues, interest in public affairs, to introduce issues relating to public administration, ethics, corruption and anticorruption programs to education, etc. Anticorruption strategy is spiral movement, when public pressure arouses required reaction of politicians towards acceptance of system changes restricting area for corruption and making repression more effective.

Public opinion –> political will –> rules –> implementation-> control –> public opinion⁵

2.4. *Are firms required to certify during the procurement process that they have not bribed an official? What sanctions can be applied to firms and individuals who have engaged in corruption or bribery in your jurisdiction.*

11. Bidders in a given tender do not officially certify that they have not bribed.⁶

⁴ See, for example Putman (1993).

⁵ For further information see Zemanovicova, D., Beblava, E.: *Krajinka rovných a rovnejsich*, Kalligram (Country of the Equals and the More Equals), 2003.

⁶ From incentive of non-governmental organisation the Anticorruption Charter was prepared, having been signed by more than 30 firms and having been supported by business associations. It includes also

12. In the Slovak Republic corruption (taking as well as offering bribes) can be prosecuted on the basis of the Criminal Code, the Commercial Code and the Act on Public Procurement. For example depending on the gravity of the conduct an imprisonment up to 15 years may be imposed for corruption. The Commercial Code considers bribery to be the one of the forms of unfair competition (§49). The Act on Public Procurement in the article 26 states that corruption behaviour constitutes barrier to participate in public procurement (in conditions of participation relating to personal status it is stated that bidder must prove that he/she or his/her statutory body was not convicted of corruption).

2.5. *Who are the competent authorities for prosecuting corruption cases? Does the competition authority have any power in this area?*

13. In the Slovak Republic, corruption constitutes in the meaning of the Criminal Code delict, which is investigated by law-enforcement agencies. The competition authority has no powers in prosecuting corruption cases.

3. Collusion

3.1. *What factors facilitate collusion in procurement? What industries seem especially vulnerable to bid rigging?*

14. Factors, which facilitate collusion in procurement, are namely:

- High market concentration – relatively few subjects operate in the market and it is easy to identify competitors, or when the number of firms is rather great, but small group of important suppliers exists here and other ones are “marginal” operating only in the small part of market;
- Repetitive bidding - competitors repeatedly meet within more tenders, which allows for them to agree on a “win-win” solution for all in a certain timetable. Environment is favourable for collusion, if competitors meet each other and have created also platform for regular contacts, for example on the association ground;
- Product character – if product is homogeneous, not liable to frequent innovation, technological changes;
- Relatively high barriers to entry;
- High level of market transparency exists – although obligatory publishing of information allows better orientation in the market for competitors, detection of corruption, but it may also support collusion, because it eases control of the fact whether “agreed action” is met and whether someone is not “cheating”.

15. Investigation of the Office focuses mainly on sectors, where products are homogeneous, in the market operate a small number of companies, there are a repetitive bidding and barriers to entry, stable market conditions and no dynamic technological changes. Sectors which may be affected by this practice are mainly the ones, where volume of public contracts is high, for example transport infrastructure. According to study by J. Pavel (2009) investments into transport infrastructure in the Slovak Republic have been stabilized during the years 2001 – 2007 at level of 1,7% GDP.

commitment not to offer bribes and not to coordinate bids within public procurement; sanctions for breaching the commitment are agreed in it.

3.2. *What sectors in your jurisdiction were affected by bid rigging conspiracies in public procurement? What experience has your agency had in helping design procurement systems in order to minimize the risks of bid rigging?*

16. The Office has not dealt with many cases of bid rigging so far.

17. In the year 2006 it issued decision concerning of bid rigging and imposed a total fine in the amount of 1 349 290 000,- SKK (44 788 222 EUR) to the six building companies for coordinating their bids in tender for realization of a section of the motorway D1. The decisive proof was the price bids concordance (of the indexes of unit prices of particular items) of particular participants to this tender, which is marked, non-standard and it has not been possible objectively to explain otherwise. This fact has been proved by many independent sources – the procurer standpoint, expert standpoint, economical analysis of bids in similar tenders and their comparison with this tender. And also no participant to the proceedings submitted any relevant proofs, which would logically explain this concordance.

18. The Regional Court cancelled the decision of the Council of the Office for reasons, which the Office considers to be non-consistent with the European jurisprudence – it obliged the Office in the case of agreement restricting competition to state place, time and manner of conclusion of an agreement in the operative part of the decision so the act could not be confused with another one. The Office submitted an appeal to the Supreme Court claiming that the act in the decisions of the Office (definition of participants, relevant market, description of conduct and time period) is identified sufficiently not to be confused with another one.

19. Apart from decision-making activities the Office has actively commented drafts of amendments of the Act on Public Procurement.

3.3. *Does your country employ certificates of independent bid determination? When firms have engaged in collusion, should they be prohibited from bidding in public procurement auctions for a period of time?*

20. Certificates of independent bid determination (CIBD) have not been used in the Slovak Republic so far.

21. Pursuant to the Act on Public Procurement only bidders who have not been convicted of breaching professional obligations within last three years can participate in tenders. Mainly participation in agreement restricting competition in public procurement and other serious breach of the law or serious breach of contractual obligations, which may be proved by final decision of relevant public power body, are considered to be serious breach of professional obligations. Time period begins on the day, when a decision becomes final. Real impact is doubtful because the courts are deciding on appeal even several years.

4. *Fighting collusion and corruption*

4.1. *What cases from your jurisdiction have involved both corruption and collusion in public procurement?*

22. We have not dealt with cases, where corruption and collusion in public procurement have been reviewed in parallel in the Slovak Republic. The biggest case in the matter of bid rigging is mentioned in point 3.2.

4.2. Have collusion and corruption cases or allegations occurred predominantly at the local government level, provincial government level, or national government level?

23. Empirical data indicate that perception of corruption in public procurement is very high. According to survey realised by FOCUS agency of March 2006 in the Slovak Republic 60% of respondents think that corruption behaviour in public procurement occurs often, 22% nearly always, 10% only exceptionally and only 1% thinks that it never occurs. According to surveys corruption occurs in the Slovak Republic both at the central and also local level.⁷

4.3. What methods and techniques for fighting corruption would aid the fight against collusion?

24. Both collusion and also corruption have serious anticompetitive impacts. While collusion is realised horizontally and its aim is to manipulate bids of undertakings in the manner that the best bid from value for money view would not win, but that “win-win” solution for participants to cartel would be agreed. Thus the winner is agreed in advance and compensations for the others may be various – for example win in next tenders, subcontracts, financial compensations. The result is inefficient use of public funds (estimates point to surcharge up to 20%⁸) and distortion of competition conditions.

25. As for corruption it is vertical relation between procurer and one of bidders, which causes that unbiased selection of the best bid will not happen, but undertaking determined in advance will acquire contract. The manners of preferring may be various – setting the criteria favouring bidder, limited information on tender, applied tender method, selection criteria, provision of further information, or agreed conclusion of supplements to contracts. Alike, the result is inefficient use of public funds (estimates point to surcharge up to 30%) and distortion of competition.

26. In the markets, where corruption and cartel behaviour are applied in the long time period it may come to the fact that firms with correct behaviour cannot operate in the market and it may act also as barrier to entry.

27. There are some techniques that can help to fight corruption and also collusion:

28. Increase of number of bids may hinder both corruption transactions and also cartel agreements and their stability. According to many studies higher number of bids means also decrease of price for public sector.⁹ Study by J. Pavel¹⁰, which analysed contracts in transport infrastructure area in the Slovak Republic during the years 2005 – 2009 confirmed inversely related relation between number of bids and price. Each additional bid brings in participation of two to five subjects within tender price decrease within 5 – 8% of anticipated price.¹¹

⁷ For further information see www.transparency.sk.

⁸ A. Capobianco: *OECD Guidelines for Fighting Bid Rigging in Public Procurement, International Seminar on Competition Enforcement*, Bratislava, 2009.

⁹ For example, Kuhlman – Johnson (1983): *The number of Competitors and Bid Prices*. Southern Economic Journal. 1983, vol. 50. No. 1., Gomez-Lobo-Szymanski (2001): *A Law of Large Numbers: Bidding and Compulsory Competitive Tendering for Refuse Collection Contracts*. The Review of Industrial Organisation. 2001. vol. 18, No. 1.

¹⁰ J. Pavel: *Ako ovplyvnuje pocet uchadzacov o verejnu zakazku cenu?* (How does the number of bidders for public contract affect the price?) Transparency International Slovakia, 2009.

¹¹ It is significantly more than it was identified in USA (2%) and about same also in the Czech Republic.

29. Clear, non-discriminating requirements and specifications focused on outputs and outcomes rather than description of concrete product extend number of bidders and at the same time hinder corruption transactions.

30. Joint procurement may hinder conclusion of collusion. Although, higher contract value provide an incentive for firms to offer bribes and for officials to take them, various anti-corruption and anti-collusion tools may be concentrated on big procurements, for example CIBD, Integrity pacts and other control mechanisms. Big tenders are usually more monitored by media.

31. E-procurement may have anti-corruption and anti-collusion effects; Slovakia has not had many experiences in it.

32. Efficient control system of use of public funds would motivate procurers to find savings through intensive competition of bids without corruption and collusion. Active cooperation with competition authorities in disclosure of cartels can be assumed. For example, according to survey,¹² which was focused on measures, which have been accepted by procurers, in which the Supreme Audit Office and the Office for Public Procurement found breach of the Act on Public Procurement, it was found out that only 64% of subjects react to findings of control bodies by appointment of responsible person and even less (53%) adopt remedies, which would prevent from breaching the Act on Public Procurement in the future.¹³

4.4. *When individuals or firms have engaged in bribery or corruption, are they able to receive leniency in your jurisdiction?*

Yes. Conditions of leniency are regulated only by the Act on Protection of Competition and it does not set such condition (that it cannot be bribery, corruption). The Office has not dealt with such case so far.

5. *Advocacy*

5.1. *How do regulatory or institutional conditions help facilitate bid rigging and corruption?*

33. Formal rules that facilitate corruption and bid rigging are described in 2.2 and 2.3.

34. If control of efficiency of public funds expenditure is only formal, it does not motivate procurers to cooperate in disclosure of collusive conduct, which increase price of public contracts. Alike, there is not pressure on procurers to set tenders in the manner, that they minimize price through maximizing the competition (for example extension of number of bidders, application of competition procurement methods).

35. As it is difficult to prove corruption and collusion in public procurement, we consider it important that relevant institutions can ensure effective disclosure and sanctioning, thus that risk of disclosure of such dangerous conduct is high and real. For example in the Slovak Republic there is a problem with the judicial review of the Office's decisions. For example, if real sanctions for collusion do not impend, because the judicial review requires the standards of criminal law, then this creates conditions facilitating bid rigging, because risk of sanctioning is very low.

36. Low transparency, non-existence of accountability mechanisms and low public control hinder disclosure of corruption cases and do not act as prevention. As corruption cases in big public contracts are

¹² Realised by Transparency International Slovakia of the year 2009.

¹³ For further information see Efficiency of Functioning of Control Systems of Public Procurement in Slovakia, Transparency International Slovakia, 2009.

connected also with financing political parties it is necessary that clear political message to disclosure and sanctioning corruption is sent.

5.2. *In what ways can competition authorities work to improve the efficiency of public procurement?*

37. Competition authorities may actively participate in creation of public procurement legislation. For example in 1991 the Office initiated the Governmental Resolution on Establishment of Public Procurement. The Office actively comments submitted amendments to the Act on Public Procurement.

38. Interventions against bid rigging are the main tool of competition authorities.

5.3. *What steps have been taken to improve the efficiency of the public procurement process in your jurisdiction? What specific measures (if any) have been adopted to reduce collusion and corruption in public procurement? If so, what has been the experience to date? Have other approaches to reduce collusion and corruption been tried in your jurisdiction and what have been the results?*

39. In the Slovak Republic for example joint procurement of some items was tested through pilot projects, some goods and services are procured in this manner nowadays. The Office pressed the fact that it should be opened system, thus if procurer finds more favourable bid comparing to conditions within general contracts, it could procure independently.

40. In the Slovak Republic on a basis of incentive particularly by non-governmental organisation many analyses relating to public procurement¹⁴ were realised and many anti-corruption tools in this area¹⁵ were suggested. Integrity Pacts – agreements concluded by procurers with bidders, aim of which is to ensure transparency and exclusion of anticompetitive conduct in the tender, were the one of the suggested measures. Both undertakings and also procurers commit themselves not to offer or take bribes. Apart from other commitments bidders commit themselves that they made and will make no agreements or other forms of coordinated conduct with other participants to given tender. Commitments are accepted both by procurers and also bidders, they agree also on sanctions for not meeting them (for example rejecting contract before its ratification, exclusion from next procurements organised by the same procurer).

41. Problem in the Slovak Republic is that information how public procurement system could be improved exist, but it is not used and is not enforced and supported by politicians and procurers. Hence, it would be appropriate to discuss establishment of certain obligatory minimal standards for public procurement area at international level from anti-corruption and anti-collusion effects view.

5.4. *When adopting measures to reduce collusion and bid rigging in public procurement, have you taken into account the impact that such measures may have on the risks of corruption?*

42. As it was stated, both corruption and collusion lead to inefficient use of public funds and restrict competition; therefore it is necessary to find balanced solutions. Requirement of maximal transparency is key issue to fight against corruption efficiently. Important indications of corruption are additional increase of contractual price, protraction of fulfilment, conclusion of supplements to contracts, non-enforcement of contractual penalties, what constitute information, which is not so sensitive from collusion view. To

¹⁴ For example studies How to Proceed within Public Procurement, Monitoring Public Procurement at Local Level, Transparency of Public Procurement Market in the Slovak Republic, Assessment of Transparency Rate of Public Procurement, Efficiency of Functioning of Control Systems of Public Procurement, Information Minimum of Public Procurement Process, Ethical Code in Public Procurement. Transparency International Slovakia.

¹⁵ For further information see for example www.transparency.sk.

prevent from publishing information, which may ease collusion it is possible to consider, which information and in what form will be provided to participants to tender and to the public. For example, it can be considered that information, which is sensitive from collusion view, would be accessible in individualized form to control institutions (in the Slovak Republic, for example the Office for Public Procurement, the Supreme Audit Office) and publicly accessible in modified form, which allows control of corruption. In this respect it would be appropriate to create best practices in this area.

5.5. *Has your competition agency undertaken competition advocacy in this area?*

43. Office has prepared Indications of Anti-Competitive Conduct of Undertakings within Public Procurement, which has been published on its website and sent to all relevant procurers with request to cooperate. The Office presented this topic at many conferences focused on public procurement area. The Office has offered also cooperation to the Office for Public Procurement. However, the Office has received no incentive on suspicious conduct within public procurement from procurers or the Office for Public Procurement; it has not received information on the fact that some procurer would like to consult non-standard situations. Lack of interest and low motivation of procurers are the problem.

5.6. *If your agency has prosecuted procurement corruption or collusion cases, what type of remedies have you considered?*

44. The Antimonopoly Office of the Slovak Republic is authorised to proceed only in collusions, it is authorised to prohibit such conduct and to impose sanction up to 10% of turnover.

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