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SERIAL OFFENDERS: WHY SOME INDUSTRIES SEEM PRONE TO ENDEMIC COLLUSION

Contribution from Korea

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SERIAL OFFENDERS: WHY SOME INDUSTRIES SEEM PRONE TO ENDEMIC COLLUSION

-- Korea --

1. Areas that are susceptible to cartels

1. When talking about areas that are particularly prone to cartel activities, bid rigging in the Korean construction industry is a good case in point. Bid rigging is a type of cartel that is considered the most anti-competitive among other types of competition law infringements. Bid rigging was designed in the first place to avoid competition among competitors. As a result, it reduces consumer welfare, allocates resources ineffectively, and stifles technological development. In particular, bid rigging in public procurement raises prices higher than the prices usually set by competition, thereby providing stable monopoly gains to cartelists while costing governments and taxpayers' significant amount of money.

2. In Korea, the construction industry accounts for 8% of total employment, or 1.8 million. The industry is a vital component of the Korean economy, taking up 10 ~ 15% of the national economy and 20 ~ 25% of the regional economies. However, Korea's construction industry is currently grappling with the effect of the 2008 global financial crisis and the subsequent recession in the housing market. Against this backdrop, many companies rigged the bids for large-scale public construction projects which were placed from 2009 to 2011. The Korea Fair Trade Commission (hereinafter "KFTC") has detected and punished a total of 91 bid riggings since 2010. Trillions of won was imposed as surcharges, bringing construction companies to a worse situation. As of the second quarter of 2014, the average operating profit of Korea's construction industry stood at 1.4%, which is much lower than that of the Korean industry as a whole, which was 4.2%.

3. Korea used to divide bid rigging cases into price cartel, output control, and market division cases. But the Monopoly Regulation and Fair Trade Act (Korea's competition law, hereinafter "MRFTA") was amended in 2007 to treat bid rigging as one independent type of cartel. This was to prevent confusion caused by enforcing law against bid riggings in several categories such as price cartel or output control, when in fact there are not many differences between them in terms of the nature of the violation. It was also a recognition that bid rigging in public procurement or public projects is particularly problematic in Korea. Korea suffered from so many big rigging attempts that it stipulated a separate provision on bid rigging. For example, from 2010 to Sep. 2015, **K** Global rigged 17 bids, and **H** Construction and **D** Construction manipulated 13 bids in total. During the same period, there were 23 constructors that were sanctioned by the KFTC for rigging the bids more than 3 times.

4. Bid riggers face remedies and surcharges imposed by the KFTC, and they may also be suspended from tenders up to 2 years by the procurement bodies. The KFTC has recently taken aggressive action against bid riggers, and as a result, many major construction companies in Korea have been banned from

tenders. The construction industry have raised voices that these stern measures have put many national projects on hold and prevented companies from winning overseas construction contracts. Therefore, as a way to inject vitality into the Korean economy, the Korean government lifted the bans as part of the special pardon in celebration of the 70th anniversary of the liberation of Korea on Aug. 15, 2015. However, the companies are still subject to remedies and surcharges imposed by the KFTC and to the civil and criminal liabilities.

5. As the KFTC is aggressively taking action against bid rigging, it is expected that there will be less bid rigging attempts in the construction industry. Many construction companies have also declared their determination to adopt a strong internal control system and make sure they abide by the law and pursue ethical businesses, rooting out cartels on their own. However, in order to truly eliminate bid rigging at its source, we need to examine in details what it is that makes cartels thrive in the construction industry.

2. What makes cartels thrive in the construction industry?

6. Bid riggings are greatly affected by the structure of the market and the nature of the product concerned. In terms of structure, when a market is concentrated by smaller number of enterprisers, it gets easier to adjust bidding prices, to select successful bidder, and to agree on compensation for cover bidders. When the entry barrier is higher or when the fixed price takes up a larger share, it is less difficult to raise bidding prices over the marginal cost without concerns over potential competition, therefore it is an incentive to cartel. When the ripple effect of price dumping war is greater, there is a stronger incentive to avoid ruinous competition and cartel. Furthermore, when a product has a stagnant or falling demand, or is in a mature stage, or lacks technological innovation, the competitors have to compete on such a limited demand, which brings about incentives to collude and secure profit instead of pursuing fierce competition. In addition, public procurement projects tend to face the “agency problem” in the bidding process. That is, the agent, which is the procurement body, has more information than the principal, the taxpayer, and this makes the agent inclined to pursue its own private interests or neglect its duty of supervising the procurement process.

7. Therefore, when we look at the structure of Korea’s construction industry, the industry is facing oversupply and its entry barrier is very low, which makes cartel formation difficult. However, when we take a look at each individual tender, sometimes suppliers that can participate in the bid are limited and the entry barrier is quite high. In this case, it is possible that the competition is oligopolistic. In particular, large-scale construction projects, such as turnkey projects or alternative tenders, have a high entry barrier due to the high cost of design in the early stage, so bidders often contact each other in advance and make attempts to avoid competition. These kinds of bids are only participated by a handful of large corporations because of the technological gap, burden of high design cost, and the difference in the capacity to lobby the evaluators.

8. Korea’s current bidding policies focus on price competition. For example, there is a policy that awards the lowest bid. These policies induce enterprisers to resort to cartels as a way of avoiding destructive competition. The so-called “one-company one-bid policy”(dividing one construction bid into several bids, allowing construction companies to win only one bid among them) was designed to make sure companies meet their deadlines for large-scale construction projects. However, this policy was criticized that it encourages companies to divide bidding areas and agree on transaction conditions.

9. Furthermore, the practice of bid rigging has been committed as a culture of Korea’s construction industry. The procurement organizations and construction companies, the bid participants, are not so much aware of the harmful effects of bid rigging. There are some companies that even express their blatant dissatisfaction towards the KFTC’s sanctions against bid rigging, and this reflects how the incestuous culture and unfair bidding practices have been built and deeply entrenched in the industry.

10. The lingering recession and the monopsony structure of the construction industry can also explain why the industry is particularly prone to bid riggings. Although recession persists in the domestic construction market, there are still too many construction companies in the market, which led to an excessive competition. With only one buyer dominating the market, construction companies are under a high pressure to cut their prices to the lowest possible level. Therefore, as a way of defending or resisting the recession and the monopsony, construction companies collude with one another. Some companies even argue that bid rigging was the last resort they had to take for their survival.

11. Despite such cultural and structural reasons behind the rampant bid rigging in the construction industry, bid rigging must be prevented and deterred. Korea must make sure it remains intolerant of cartels and spare no effort in improving public tender policies and making them cartel-free.

3. Lesson learned in terms of law enforcement

12. In order to root out bid riggings, it is crucial to continue detecting and sternly punishing bid riggings. The competition authority should send a clear message that should there be bid riggings, it will take strong action against it. To that end, the KFTC uses various media outlets through press releases and briefings, bringing its findings and decisions against bid riggings to the attention of a wider audience. This is a way of publicly announcing that the KFTC is absolutely intolerant of bid rigging. When certain companies are frequently mentioned in the list of KFTC's sanction, their reputations are tainted. Therefore, this approach makes companies voluntarily comply with competition law and pay more attention to their behaviors.

13. There are policies that have induced the formation of cartels in the bidding process but are outside the remit of the KFTC. The KFTC improves such anti-competitive policies by cooperating with the Ministry of Land, Infrastructure and Transport and the Ministry of Strategy and Finance. As a result of such efforts, the policy that awarded the lowest bid has changed into the policy that comprehensively examines the bidder's capacity to build, the bidding price and its social responsibility. The so-called "one-company one-bid" policy was abolished. And there is an ongoing process to change the existing policy that immediately bans any submission of bid after the finding of a part in bid rigging. Now, we are trying to design this policy to take into account the level of illegality and the severity of the liability when setting the scope and duration of such a ban on a case by case basis.

14. For your information, the KFTC has supported the OECD's stance on bid rigging (as stated in the 2007 OECD Reviews on Regulatory Reform and the Note by the Secretariat in Jan. 2008). The OECD has recommended that the ban on tender shall be enforced to the extent of not limiting competition, because restricting an entry into a future project based on the illegal conduct of the past may have an anti-competitive effect on in the market. The current Korean policies automatically take away the right to participate in the bid from the law infringer, but this can encourage yet another bid rigging. Fortunately, the relevant policies are in the process of reforming, so it is expected the Korean policies will refrain from limiting competition in the market.

15. As more construction companies are cautious about their behaviors, and the people are increasingly voicing their criticism against bid rigging, it is projected that there will be much less bid rigging attempts in Korea. Improvements are currently made on the measures relating to bid rigging, which means it would become harder for construction companies to blame the system. Furthermore, the KFTC plans to spread compliance program to more businesses, by providing systematic support and putting in efforts, so that enterprisers can voluntarily refrain from cartel activities.