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POLICY DEPARTMENT A
ECONOMIC AND SCIENTIFIC POLICY

Economic and Monetary Affairs

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Internal Market and Consumer Protection

Risks of Corruption and Collusion in the Awarding of Concession Contracts

NOTE

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Abstract

This briefing note describes the risk of undue influence, corruption and collusion on sector-governance decisions and the award of concession contracts. State intervention to reduce market failure easily creates a risk of *governance* failure, and this concern must be addressed to secure the intended combination of market forces and sector regulation – as is so well offered by concession contracts. Harmonised EU legislation specifically on the award of concession contracts is an important step to reduce the mentioned risks, particularly because it will make undue influence on these markets more visible across Member States and develop a common understanding of how to best secure 'value for money' for consumers. However, the impact of the new rules on the award of concession contracts will depend not only on how carefully they are implemented, but also the quality of a broader set of integrity mechanisms within the respective Member States. Hence, while the law is an important step towards securing efficient regulation, we need checks and balances on the many decisions that are still up for discretionary judgment by politicians and civil servants with sector oversight responsibility.

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AUTHOR

Dr Tina Søreide, University of Bergen, Faculty of law, Norway

RESPONSIBLE ADMINISTRATOR

Mariusz Maciejewski
Policy Department Economic and Scientific Policy
European Parliament
B-1047 Brussels
E-mail: mariusz.maciejewski@europarl.europa.eu

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EXECUTIVE SUMMARY

Numerous cases throughout Europe and the rest of the world confirm a certain risk of corruption and collusion in regulated sectors. The main reasons why some sectors regulated by concession contracts might be at particular risk are the specific need for state intervention, the potentially large profits secured by influencing award processes and terms, and the complexity of some of the sectors and contracts, which makes it difficult for independent third parties to assess how well the deals secure the interests of consumers and citizens.

The introduction of more coordinated and harmonised procedures for the award of concession contracts will reduce the risks of undue influence. It will make deviation from the rules more visible, including to independent experts as well as the media across Member States. It will require a comprehensive implementation process where the procedures and their motivation will be carefully considered. Moreover, the rules represent best practice internationally and include instruments that will make it easier for the respective governments to secure more optimal solutions. Whether the set of rules needs to be as comprehensive as drafted is debated in this note. A more flexible set of procedures with more discretion would have to be combined with clear allocation of responsibility and makes it possible to hold institutions (and possibly individual civil servants) and politicians accountable for the ex post result of ex ante judgment.

This briefing paper underscores the importance of general institutional quality and checks and balances at the highest level of governance. Parliamentary controls, auditor generals, independent courts, a free press and civil society are all essential elements of a governance integrity system. The new law will depend on the quality of these institutions to provide the intended impact on service performance, particularly since the governance of these sectors is so 'politicised'. A lesson learned from World Bank experience across the globe, where attempts have been made to "fix governance from the sector level", is that we cannot expect procedures for the award of concessions to compensate for other serious institutional dysfunctions. Such 'dysfunctions' are more serious in developing countries, yet – as so clearly demonstrated by the financial crisis – the concern is far from 'totally irrelevant' in EU Member States. Obviously, though, this should not be understood as if well-functioning integrity mechanisms will make the law redundant. None of the pillars of an integrity system include the requirements needed to secure a free and fair award of concession contracts. We need a law specifically for this purpose, as explained in more detail in this note.

We should not assume that this new law will unburden difficult political trade-offs from all forms of undue influence. The new procedures will not (and given other democratic goals, *should* not) reduce discretion at political levels. However, the set of procedures will contribute importantly to make undue influence in politics more difficult – and also more visible to outsiders when it happens. For such a purpose, the transparency mechanisms of the drafted law should be further strengthened. Independent observers should be allowed to make informed assessments of how these concessions offer 'value for money' for citizens. Experience from reform in developing countries suggest that resistance against such transparency initiatives may come from civil servants with sector oversight responsibility, rather than from the private sector – as often assumed.

In addition to the concerns about governance and the need for expanded access to information, this briefing note lists the potential areas for further improvement of the drafted directive:

i. Government representatives involved in sector-regulation and award procedures should be held responsible ex post and excluded from decision-making if there is suspicion of bias.

ii. There is serious risk that corruption and collusion are combined and thus difficult to reveal by institutions focusing on only one of the challenges (i.e. competition authority and financial crime unit).

iii. Rules of exception are at particular risk of being manipulated and there may be a specific need for ex post justification and control when those are applied.

iv. Contract transparency should be applied as far as possible and independent control by (independent) sector experts should be facilitated (while independent regulatory agencies are supposed to serve this role, additional controls are needed to reduce the risk of regulatory capture).

v. The reaction against firms that have already been involved in some form of illegal practice for market benefit may have to be reconsidered. It should not eliminate firms that have already been penalised for some offense. It might be sufficient to pursue a stricter responsibility of individuals involved in collusion and/or undue forms of influence, instead of punishing the company as a whole.

vi. The trade-off between comprehensive rules on one side and discretion combined with clear allocation of responsibility depends on the general set of integrity mechanisms in society. Transparency mechanisms should be further strengthened where possible.

1. INTRODUCTION[1]

Concessions contracts are used in markets where a certain level of government regulation is required for example because the allocation of goods and services by a totally free market is not efficient. This is the case for several forms of public services, such as water supply or electricity provision, and for infrastructure, like maintenance of roads, ports and to some degree, telecoms, where natural monopoly characteristics make competition difficult. Moreover, concession contracts are used to regulate the use of protected wildlife areas (like tourist operations in national parks), the production of renewable and non-renewable natural resources, and markets where uncontrolled entry may lead to adverse effects for consumers, such as the transport sector.

The case for government intervention in these markets is generally well recognised and understood and stems from the need to protect consumers or resources, or secure the provision of basic services at a reasonable price. For this purpose, governments have a menu of instruments at their disposal, including price and quantity regulation, taxes, subsidies, assignment of property rights, or they can simply take over a firm or a sector. However, the concession contract is a particularly useful tool because it allows a combination of politically selected regulatory conditions and the opportunity to let market forces generate welfare benefits. In contrast to lease contracts and management contracts, it places the benefit of efficient investments for operation on the side of the firm, and therefore, given the impact on incentives, concessions are often preferred to other modes of regulation.[2]

In the concession award process, eligible firms bid for the exclusive right to operate a concession for a given period under the given conditions set by the contracting authority or entity. By the tender competition they are encouraged to offer as good match as possible between prices and relevant qualities, or depending on the competition, as high amount as possible for the exclusive right to operate the concession – an amount that typically depends on how efficiently they think they can provide the given services. Even if there is a tender process for concession contracts, the procedures should not be confused with public procurement – where the sole purpose is to buy goods and services at the best possible price-quality combination. A concession contract, as described above, is a form of regulating a sector for the protection of consumers or other values.

The exclusive right to operate as a *concessionaire* may seem lucrative for the service providers, given the strong market position it offers. In practice, however, the mentioned competition for the contract may reduce company profits to the margin.[3] In response, firms are likely to seek ways of moderating this competitive pressure and secure some revenues after all. This is something they can achieve by developing unique technological competence, outperform their competitors, and thus obtain profitable terms despite the competition while still benefitting consumers.

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[1] This paper is prepared in dialogue with and/or based on research collaboration with Antonio Estache, Daniel Benitez, Charles Kenny and Birthe Eriksen and repeats several of the arguments presented by Søreide (2011).

[2] More than 60% of all PPP (Public Private Partnership) contracts in Europe fall in the category of concessions.

[3] Or even negative returns, for example because of the winner's curse, which refers to the risk of offering too much just to win the competition – as described in more detail by Saussier (2012).

Other firms may lobby for award criteria that match their comparative advantages in the market, in order to secure market advantage given the technology they already have. However, there is also a certain risk that some firms try to reduce the competitive pressure in ways that are clearly damaging to society, including tacit collusion with competitors and corruption.

This is something we have seen in cases such as the recent award of concessions for the exploration of shale gas in Poland, where seven people were charged with offering or receiving bribes, including high ranking civil servants very close to the political elite.[4] Several allegations of corruption involving the British company BAE tell us about how military export licenses could be violated and how easily large contracts could be secured through corruption with few consequences 'at home'. In the UK the British government initially tried to prevent investigation because the company's contracts abroad resulted in important employment at home, regardless of how the contracts had been secured[5]. More examples follow below. How to prevent undue influence is not straightforward. The two cases mentioned took place despite existing procedures for the award of concession contracts and sector regulation, and as will be discussed over the next pages, the challenges might require not only sector-specific improvements, but also, well-functioning checks and balances at the political level.

This briefing note elaborates on the risks of corruption and collusion in concessions markets, and discusses how certain details of the concessions rules and system can contribute to prevent these challenges. The purpose of the note is to provide inputs to discussions about European Commission's proposal for a directive on the award of concession contracts (COM(2011) 897 final). The paper has been commissioned by the Committee on Internal Market and Consumer Protection of the European Parliament.

[4] The case was much debated in the media, see for example www.reuters.com on 10.01.2012: "Poland detains 7 suspected of shale gas corruption".

[5] *The Guardian* has collected these corruption stories under "The BAE Files", see: http://www.guardian.co.uk/world/bae

2. WHY CONCESSIONS MARKETS ARE EXPOSED TO ANTI-COMPETITIVE BEHAVIOUR

Regardless of political views on how much a state should intervene in markets, there are some challenges that are directly harmful, and should be prevented. Among these are corruption and collusion, and in order to combat such forms of undue influence on procedures and markets we need to know why they can occur.

2.1. Reasons for concern

While we have few facts about the consequences of tacit collusion and corruption, there are many allegations and court cases throughout Europe that confirm the risk of such challenges.

A French **water company** has been involved in several cases where bribes have been offered to influence the award of concession contracts, including in other European countries. According to a civil society organisation, Centre for Public Integrity, "…in France, both Suez and Vivendi <two private water companies> have come under scrutiny in a host of criminal and civil cases, with accusations that include bribery of public officials, illegal political contributions, kickbacks, price fixing, operating cartels and fraudulent accounting". They were not charged on all offenses, allegedly because of their political connections. The organisation points at how water companies have been an important source of income for political parties. Their report lists a number of violations of regulatory and award principles, instigated by the firms as well as government representatives. Even if the cases took place some years back, they serve as good examples of the risks addressed in this paper.[6]

Over the last decade, the European Commission conducted several antitrust investigations concerning **electricity supply** in Europe, at one point claiming it to be characterised by "artificial bottlenecks in transmission, inflexible long-term contracts, and purchase obligations in supply contracts with industrial consumers".[7]

[6] See for example "Water and power: The French connection" by the Centre for Public Integrity: http://www.iwatchnews.org/ and http://www.iwatchnews.org/2003/02/04/5711/water-and-power-french-connection

[7] See the European Commission's website on competition in electricity markets for information about its sector inquiries and results: http://ec.europa.eu/competition/sectors/energy/electricity/electricity_en.html

Box 1: European Commission on the electricity market, 2007

A report published in 2007 revealed serious distortions of competition in the sector, in particular (bullets are copied from the summary on the EC website, see footnote – emphasis added):

- Most wholesale markets remain national in scope, with *high levels of concentration* in generation, which gives scope for exercising market power.
- Vertical integration of generation, supply and network activities, which *reduces the incentives to trade and for new companies to enter* the market, has remained a dominant feature in many electricity markets.
- The *low level of cross-border trade* is insufficient to exert pressure on (dominant) generators in national markets.
- There is a *serious lack of reliable and timely information (transparency)* in the electricity wholesale markets that is widely recognised by the sector.
- Price formation is complex, and many users have *limited trust in the price formation mechanisms*.

According to the Commission, there have been cases of undue influence and collusion in several sectors. One example is the **information communication technologies** (ICT) sector, where several companies have been accused of abusing their dominant position and profited too much at the expense of consumers[8]. Another example is **air freight and freight forwarding services**. Upon severe price fixing internationally and outside Europe, the European Commission responded in December 2007 by sending a Statement of Objections to 25 airlines alleging that they fixed the prices of air freight services in violation of the EU rules on restrictive business practices. On November 9, 2010 the European Commission convicted 13 airlines of which 11 were fined 800 million Euros. An EC Press Release on 09/11/2012 (reference IP/10/1487) states the following:

"The European Commission has fined 11 air cargo carriers a total of EUR 799.445.000 for operating a worldwide cartel which affected cargo services within the European Economic area (EEA). Several known airlines are among the 11 undertakings fined, namely Air Canada, Air France-KLM, British Airways, Cathay Pacific, Cargolux, Japan Airlines, LAN Chile, Martinair, SAS, Singapore Airlines and Qantas. The carriers coordinated their action on surcharges for fuel and security without discounts over a six year period. Lufthansa (and its subsidiary Swiss) received full immunity from fines under the Commission's leniency programme, as it was the first to provide information about the cartel."

The freight forwarding case, concluded this year, led to EUR 169 million fine on 14 groups of companies involved in freight forwarding services. According to European Commission Press Release on 28/03/2012 (reference IP/12/314) the freight forwarders colluded on surcharges and charging mechanisms concerning important trade lanes, in particular the Europe-USA and the China/Hong Kong-Europe lanes.

[8] See European Commission website on competition in Information Communication Technologies (ICT) http://ec.europa.eu/competition/sectors/ICT/intel.html, which states: *"On 13 May 2009, the European Commission adopted a decision finding that Intel Corporation infringed Article 82 of the EC Treaty by abusing its dominant position on the x86 central processing unit (CPU) market. The decision imposed a fine of EUR 1.06 billion and obliged Intel to cease the identified illegal practices, to the extent that they are ongoing, and not to engage in the same or equivalent practices in the future."*

There have been repeated irregularities in the award of removal of rubbish contracts in the south of Italy, also involving organised crime. In 2009, a central politician was accused of providing outside support to the illegal activities of the camorra mafia in relation to the collection, transportation, and disposal of garbage in the Campania region. However, the undue influence on **waste management** contracts has been a serious challenge in the region for more than fifteen years.[9]

Allegedly, Kazakhstan **gas pipeline concessions** have been subject to undue influence at (and from) political levels, involving European politicians, a situation that is difficult to prevent by concession award procedures.[10]

The German company Siemens was penalised for paying **bribes to gain big public contracts** in several sectors and countries, including concession contracts, a practice made possible by the presence of **tax havens and secrecy practices**, including in European jurisdictions.[11]

The list of examples could continue. There are cases of undue influence and/or tacit collusion in concessions-based operations throughout Europe and the problems have not at all been sufficiently dealt with. A recent report, published by Transparency International in June 2012, presents a careful assessment of corruption across European countries and suggests that regulated sectors – exposed to political interference and limited competition – are at very high risk of undue influence (see Section 2.3.2 for more information about these results). Clearly, the risks of undue influence on sector regulation are relevant also to European countries that score well on accountability rankings.[12]

The following sections describe the main underlying factors that may contribute to corruption and collusion and anti-competitive behaviour more generally in the identified sectors.

[9] See 'Garbage crisis and organized crime' in *Naples Politics* on 20.11.2009: http://naplespolitics.com/2009/11/20/garbage-crisis-and-organized-crime/

[10] See *Foreign Policy* August 2012: 'The Great Pipeline Opera': http://www.foreignpolicy.com/articles/2009/08/12/the_great_pipeline_opera?page=full

[11] See article at *Frontline World*: 'At Siemens, Bribery Was Just a Line Item': http://www.pbs.org/frontlineworld/stories/bribe/2009/02/at-siemens-bribery-was-just-a-line-item.html

[12] http://www.transparency.org/news/feature/enis

2.2. Sector characteristics that increase the risk of undue influence

Industries in need of regulation due to market failure tend to feature various characteristics that make it possible for particular interests to exert undue influence over contractual arrangements. Furthermore, the complexity of the activities and number of players involved may prevent effective monitoring and greater transparency of market decisions. The set of procedures for the award of concession contracts should be considered in light of how well it prevents attempts of distorting otherwise welfare-enhancing market mechanisms.

2.2.1. Risk of government failure while government intervention is needed

Most concession markets have characteristics that require at least some form of government ownership, intervention, or regulation. Economy of scale has made it difficult to draw benefits from competition in these sectors. For example, it is simply not cost-efficient to invest in several sets of railway lines even if this would secure competition between railway companies. One and the same city cannot have several ports to secure competition if only one port is geographically achievable. We may want to avoid too many coffee shops or bars serving alcohol in the same street, even if competition serves to reduce prices for consumers. The many situations where market forces should be steered to the benefit of society justify government regulation and thus, control of access to the sector and sometimes prices.

Moreover, several of the relevant services, such as utility provision, are essential in any developed society, and their provision is often considered a government responsibility, even if the utilities themselves are privately owned (e.g. water distribution or waste management). Besides, several of the sectors require substantial capital investment and private firms may depend on government subsidies, investment or guarantees. The values at stake might be large, particularly for utility sectors, where also the contracts and financial setup are often complex as well.

For these different reasons, there is an important role for governments to make sure that service provision and production are carried out in accordance with the interests of society, rather than biased toward the interests of one party or another. This is also how it works in practice in most settings in Europe; the government regulates the sectors to the benefit of society at large while consumers, including industries, get access to essential services at a reasonable cost and predictable quality. However, with government intervention we also see more attempts from the private sector of influencing government decisions.

The risk of undue influence on regulatory decisions is present whenever competition is limited, including in markets regulated by concessions, and is **the main reason why we need solid procedures** that make it clear how the decisions should be made and when they are violated.[13]

[13] For more comprehensive explanation, see Laffont and Tirole (1991) and Thatcher (2011). According to Thatcher (2011:188) these "*risks are inevitable when competition is limited. Any analysis must start from this understanding and look at how these risks have changed over time rather than assume they are zero*".

Box 2: Relevant forms of undue influence: terminology

The problem of private players that manage to influence government decisions to their exclusive benefit and at the cost of consumers is a much debated issue in the economic literature. It is sometimes referred to as ***regulatory capture***, which means that a regulatory agency makes decisions primarily to the benefit of the industry it is set to regulate, at the expense of the wider public (see Dal Bo (2006) for a review).

Wren-Lewis (2011) separates between ***ex ante capture*** and ***ex post capture***, distinguishing between influence on the design of regulatory laws (such as this proposed directive on the award of concession contracts) and the undue influence that may take place within a given set of legislation (while making it look like as if the laws have been well respected).

State capture is an extension of regulatory capture by including the case when also the political elite has been "captured" (for example by help of some form of corruption or campaign finance) to secure profits for commercial players.[1] Another term used to describe these kinds of problems is ***client politics***, which refers to how an organised minority or interest group may have managed to secure exclusive benefits at the expense of the public.

Like ***rent-seeking***, client politics is not 'reserved for' industry regulation, but is often associated with some form of ***influence-peddling*** (including legal *lobbyism*) and already powerful industries that seek to secure their profits. Rent-seeking is used also to describe the power-or money ambitions of individual government representatives, and does not have to be instigated by players in the private sector.

The decisions of government representatives may be influenced unduly by clear-cut ***corruption*** (sale of decisions), ***revolving door-issues*** (career opportunities in the private sector), or their ownership shares in a sector.

The different reasons why individual government representatives may steer decisions to the benefit of a group of players and at the cost of voters and society at large, are sometimes referred to as "***political economy issues***". This is a highly imprecise term, but its use in policy circles reflects the fact that the more specific explanation behind observed shortcomings in a sector is difficult to determine. The processes and incentives are usually hidden and often difficult to prove or define as illegal.

Despite solid procedures, however, there are several ways for government representatives to make it look like as if no undue influence has taken place. What characterises regulated sectors is the typical presence of **multiple goals** behind government intervention. The intervention is already justified by the presence of some market failure, and given the fact that government regulation is needed, voters may well support the idea that the intervention can be 'used' to promote a long list of goals. Concerns about various consumer interests are the most obvious goals listed, but we also have the environment, unemployment, the need for attracting private capital, developing local industry or promote foreign entry.

These values may all lead to different conclusions, and thus, for the "captured" government representative, there will 'always' be a concern that fits the intention to let processes be influenced. As a result of multiple goals, the decisions – and thus also the performance of the sectors – are at risk of being subject to *unbalanced bargaining powers in negotiations* as well as *populist politics*, and this risk is more pronounced in sectors regulated by concession contracts than in less regulated sectors. Undue influence can more easily go undetected and this will prevent the function of market mechanisms.

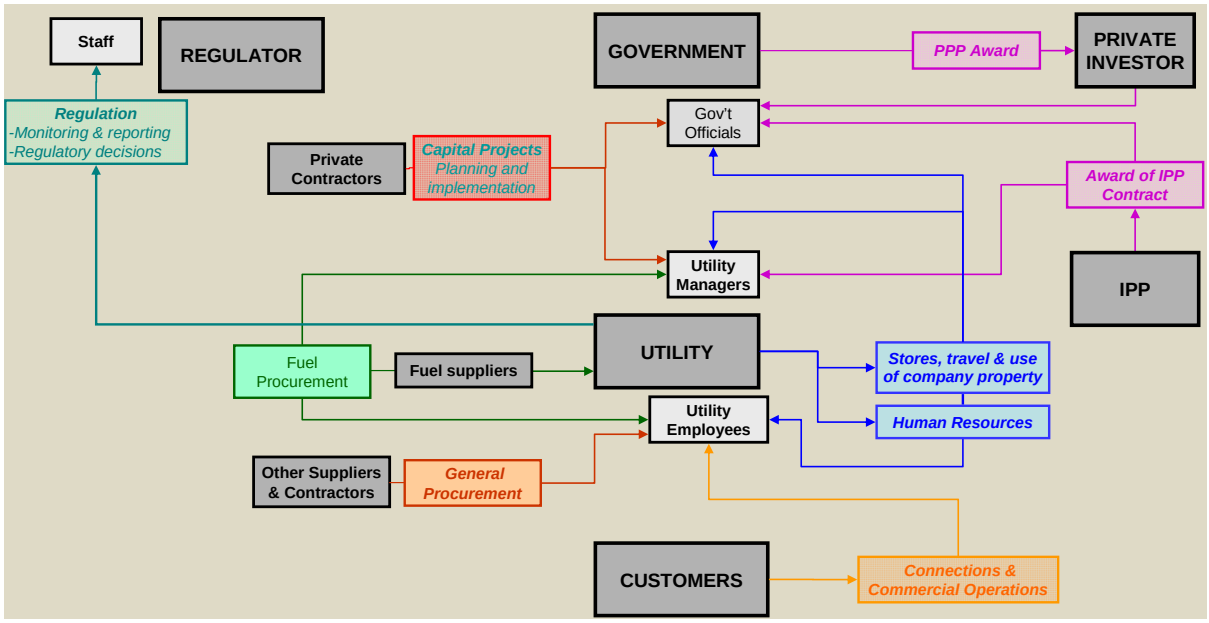
Moreover, if the goal behind sector intervention is unclear, it becomes difficult to assess how the government performs in the various deals and decisions that are up for negotiation. The multitude of values makes it possible to politically defend whatever choice has been made. This is why **the ranking of criteria** in the award procedures is so important, and should *not* be subject to political negotiations after the award process has started.

This discussion has contributed to explain why some characteristics of a sector may increase the risk of governance failure. Moreover, it is made clear why government intervention with concession contracts is **very different from public procurement**, despite the element of a bidding process in both sets of procedures. Procurement is motivated by the need for acquiring goods and services while the award of concession contracts is part of industry regulation, motivated by the risk of market failure and the need to protect consumers or other interests in society. We will consider the governance issues in more detail below. This section discusses sector characteristics that may prevent market mechanisms to work as intended. However, the risks of undue influence may vary significantly across regulated sectors.

2.2.2. The complexity of some of the sectors

Understanding fully how players in the network industries can influence the terms under which they operate demands an appreciation of **the complexities of each industry**. As an example, Figure 1 illustrates the many decision units and players involved in electricity supply. Some decision nodes in the illustration are more relevant than others for facilitating or preventing unfair competition. These include (from the left) regulatory decisions, the planning and implementation of capital projects, the award of concessions, and the details of risk allocation.

Figure 1: Industry structure, electricity supply



Source: Diagram prepared by Castalia, a US-based consultancy, for the World Bank.

The illustration in Figure 1 also indicates that players in some of the complex sectors industries, such as network industries, might have multiple channels through which to influence their terms. Hence, **risks of undue influence are present before, during and after the process of awarding** concessions[14].

2.2.3. Multiple channels for exercising influence

As suggested in Table 1 below, the channels for exercising (reasonable and undue) influence include three broad categories: (a) taking direct action to affect competition (which is supposed to be regulated by competition law); (b) reducing the cost side of the profit function—including transaction costs, access to credit, and favourable outcomes of court decisions; and (c) exerting political influence to have regulatory decisions diluted or reversed, to alter the legal framework or its interpretation, or to enlist diplomatic support to gain benefits in public procurement and concessions award processes in foreign markets.

Table 1: Channels of influence for market benefit

Reducing competition	Lowering costs	Exerting political influence
Cartel/market sharing	Taxation	Design of concessions award criteria / direct awards
Mergers /acquisitions	Vertical cooperation/access	Ad hoc interference in competition control
Entry barriers	Access to credit	Regulatory decisions kept subject to discretional judgment
Single-source supplier agreements	Biased enforcement of the law	Diplomatic pressure for award of concessions contracts

Source: Søreide (2007)

The table summarises different ways or channels in which firms may seek to exercise undue influence with a view to obtaining greater benefits. It is worth noting that the regulatory authorities, when seeking to address these different channels, tend to focus primarily on the first category (reducing competition), leaving the other two categories to other 'integrity systems', such as various democratic mechanisms and constitutional checks and balances (such as control by a parliament, regulatory bodies, such as tax authorities, independent courts, control of financial transfers, access to information, and more). In order to understand the risk of undue influence on sector decisions, we **have to consider all channels through which competition can be reduced** to the benefit of a sector or individual firms.

[14] See Ruzzier (2011) for a recent discussion of sector-specific challenges in European infrastructure governance and policy implications.

2.2.4. Competition does not remove the need for anti-corruption

Influence may be exerted in ways that are legal and acceptable, or in ways that are illegal or otherwise unacceptable[15]. It may well be argued that the difficulties of distinguishing between what is legal or not should lead us to concentrate primarily on pro-competition mechanisms, since more competition will tend to dampen both the exercise and the effect of influence, legal or otherwise. This is a valid argument — and also the view pursued by the World Trade Organisation (WTO), for example, which focuses on promoting clear standard public procurement rules *rather* than anticorruption rules.

Successful implementation and enforcement of pro-competition mechanisms will help reduce the opportunities for rent-seeking and the different forms of undue influence. However, there may be various 'grey zones' of influence, as shown in Table 2 below.

Table 2: Grey zones of influence

LEGAL				*LEGAL GREYZONES*					*ILLEGAL*
Honest and professional business conduct									
Ordinary marketing									
Marketing targeted at specific individuals: exclusive excursions, sports tickets, gourmet evenings, etc.									
Unsolicited proposals, with all details of an unplanned project prepared									
Middlemen and agents, 'personal relationship is what counts'									
Gifts to political parties – by condition of a certain benefit									
Quid pro quos – a way of covering corruption?									
'Facilitation payments' – 'to get the procedures going'									
Bargaining on opportunities for reconcessioning (profitable solutions for the firm)									
Violations of rules of communication (as if they were not important)									
Persuade politicans at home to put pressure on local gvms. (difficult to prosecute)									
Acquire secret information about evaluation, use of 'fronts'									
Misuse of 'facilitation payments' (makes corruption 'less illegal')									
Expensive gifts to people involved in the tender procedure									
Buy secret information about competitors' bids									
Local partnership with relatives of people with authority									
Bribes to individuals with influence on the procedure									

Source: Søreide (2007). A clear line between what forms of influence are acceptable and which are not can be difficult to draw.

Nevertheless, whether the exercise of influence is acceptable or unacceptable (legal/illegal) is relevant because they require the attention of different integrity systems (democracy or police investigation). It is also particularly important to determine if undue influence is caused by some form of governance failure (like fraud or corruption), since this is a problem with potentially vast consequences within and beyond the sector.

[15] Some forms of rent-seeking and lobbyism may be unacceptable and still not directly illegal.

Moreover, if the problem is corruption, both parties benefit strongly from a deal. The decision-maker typically benefits in his or her personal (rather than official) sphere, with bribes representing compensation for the risk and inconvenience of deviating from the goals of the institution that he or she represents. As long as the deal can be hidden, the players can achieve more through corruption than through other forms of influence where the element of compensation for the decision-maker is less present. The element of compensation (the bribe) for biased policy choices can therefore undermine attempts to improve welfare through pro-competition structures.[16] The parties involved in corruption can make it look like as if concession award processes have been respected (i.e. 'competition prevails'), and the problem may not be revealed unless it is positively searched for.

In light of the examples given above, the cases brought to court throughout Europe, as well as various perception-based indices and business surveys[17], it is fair to say that **there is definitely a risk that corruption may affect the performance of concession-regulated markets in Europe**. Both the OECD and European Union (EU) complained in 2007 that *"[M]ember [S]tates fail to implement EU legislation to combat corruption in the private sector".*[18]

Siemens, a big player in telecoms and power generation, was heavily penalised for corruption (UKP 540 million), a case that sapped confidence in the capacity of public procurement procedures to deliver cost-efficient contracts. At the same time, competition in gas delivery in Europe is the subject of "the Great Pipeline Opera," a political game involving gas supplies to Europe, in which powerful individuals appear to benefit from their undue influence[19]. So far procedures for the award of contracts have not been able to completely reduce the risk of this kind of influences. However, a set of coordinated or harmonised rules across Member States and common understanding of practices will make it much more difficult because ordinary citizens will be better able to reveal such games when they happen, both in their own country and in other EU Member States.

These forms of challenges nevertheless brings us to the question of *how, why and if* the procedures of concession contracts need to be protected from the political environment.

[16] For more discussion, see Estache and Wren-Lewis (2011), Straub and Auriol (2011), Harstad and Svensson (2006), Søreide (2009)

[17] See the websites of Transparency International, the OECD, the World Bank/IFC, The Economist Intelligence Unit, and Global Integrity for relevant surveys.

[18] For the OECD and EU statement, see EU press release with reference IP/07/848 2007 or website: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/848&format=HTML&aged=0&language=EN&guiLanguage=no.

[19] The monthly magazine *Foreign Policy*, October 2009, describes the political competition between Turkey and Russia for gas delivery to the EU from alternative sources. For explanations and examples of corruption in utilities, see among others, Estache and others (2009), Auriol (2009), Estache and Wren-Lewis (2009, 2011), and Kenny and Søreide (2008).

2.3. Governance issues and politics

While Section 2.2 listed sector characteristics that tend to increase the risks of governance failure, this section considers governance characteristics that may contribute to amplify or reduce the problem.

Since the mid-1990s we have seen increasing attention to the role of governance in market regulation, and how the quality of institutions and political accountability matter for sector performance[20]. However, as explained above, in efforts to fix market failure through state intervention, there are significant risks of governance failure[21]. Regarding empirical results, a comprehensive study of business-related corruption in transition economies by Hellman et al. (2000) found solid evidence of patterns of bribery in bypassing regulation and obtaining government contracts. According to survey results by Batra, Kaufman, and Stone (2003), corruption is a far more common business challenge in countries with few obstacles to cartel formation (correlation presented in Søreide (2008)).

Adjusting to local business practices by participating in corruption may not only provide a way to enter a given market, but entering may also be more rewarding if firms can collude without much resistance or influence their terms in other ways (ref. Table 1 above). What aspects of governance and politics are particularly relevant to avoid undue influence on sector regulation and award of concession contracts?

2.3.1. "Politicised" sector-governance

The regulated sector tends to be "politicised" - and regardless of the 'best practice' details of procedures for the awarding of concession contracts, for the private sector players it will often pay off to nurture close ties with the political elite. How much this pays off depends on institutional and democratic qualities.

Democracy, however, is also one reason why politicians and government representatives might violate their own principles and efforts to promote market mechanisms. As far as government intervention is required to secure sector performance (in some way), the performance of the given sector is easily perceived a government *responsibility* – even if the market is served by private firms. For this reason, the sectors become **important in democratic competition**, either for incumbents who want to demonstrate success or for the opposition that wants to demonstrate the incumbent's incapability. For the incumbents, it is also considered of value if they succeed in helping firms securing business abroad – for example by exercising political pressure on other governments. Such diplomatic pressure totally violates most procurement principles – and is against what values they try to promote at home.

[20] The economic literature has emphasised the role of regulatory capacity for sector performance and underscored the importance of regulatory independence from politics (Laffont and Tirole, 1994; Estache and Rossi, 2005; Ades and Di Tella, 1999; and Bliss and Di Tella, 1997). Several studies, among them Kirkpatrick et al. (2006), suggest that political instability adversely affects foreign direct investment (FDI), while Gasmi et al. (2009) point to weak political accountability as a determinant of sector performance in utilities. A literature review on the challenges is provided by Benitez et al. (2010).

[21] For more explanation of the mechanisms, see Estache (2011), Benitez et al. (2010), Besley (2006).

Another reason is the **need for private sector capital in some projects** and sectors. For some of the concession-regulated sectors, such as infrastructure, huge investment might be needed, while from the perspective of governments, private capital investment is often preferred. This brings about negotiations, where firms – reasonably – will seek some form of market advantage simply to cover their investment. In addition, the allocation of various forms of risks associated with construction and financial solutions might be decisive for the private sector to enter a deal, and this is also an important part of the negotiations. The governments face important trade-offs between less consumer-friendly market-advantages to the firm and public expenses. Procurement principles will help securing a competitive outcome also in these cases, yet it is obviously a much politicised context and the governments might want to keep the opportunity to set principles aside if they find it needed.

This means that, regardless of procedures for the award of concession contracts, profits in some of the sectors will continue to depend very much on political decisions – which means that these are sectors were lobby payments may continue to bring benefits to some firms. According to Thatcher (2011), who studied regulatory capture in European network industries, there is a clear risk that some firms are treated as **'national champions'** – which implies that they keep benefitting from political protection over time - and effectively manage to prevent competition, despite sector governance principles and award criteria.

Regulated sectors is also an area where politicians more easily can play out "hidden agendas", be it a populist power hunt, revolving door issues (seeking career opportunities in the private sector), personal enrichment (accepting bribes in return from biased decisions) or party campaign (accept lobby gifts in return for private sector-friendly governance). For these reasons, the procedures for the award of concession contracts and **principles must be bolstered by the more general set of integrity mechanisms** and political checks and balances.

Hence, for the rules to deliver better sector performance as intended, we need to have in place independent sector regulation (which prevent political interference in individual cases), a well-functioning and independent competition authority, and supreme audit institutions well able to perform performance audits.

2.3.2. The general set of checks and balances matter

"Fighting corruption needs to come from the top and that is where Europe fails the test"

– Cobus de Swardt, Managing Director of Transparency International

In a two-year project, Transparency International has analyzed over 300 institutions in 25 European countries. These are institutions of core importance for countries' integrity systems, including parliament, government, courts, national audit, media, civil society, and many more. The organisation has developed a methodology referred to as National Integrity Studies, and these have been conducted in countries throughout Europe in order to assess the quality of institutions supposed to prevent undue influence on decisions supposed to be made to the benefit for society at large[22]. While many institutions perform as intended – or are close to performing well - important weaknesses have been revealed in every country.

[22] See Transparency International's website: http://transparency.ie/resources/NIS

The report that summarises the many country studies, published early June 2012, describes challenges at the national level and across key institutions[23]. Main weaknesses across Europe are found to be the following (copied from the report and shortened, see Transparency International 2012:5):

(i) *Political party financing is a particularly high-risk area for corruption*; even countries often described as having 'low corruption contexts' have not managed to insulate themselves against this risk;
(ii) *Lobbying remains veiled in secrecy*: In most European countries, the influence of lobbyists is shrouded in secrecy and a major cause for concern. Opaque lobbying rules result in skewed decision making that benefits a few at the expense of the many. Only six of the 25 countries assessed (France, Germany, Lithuania, Poland, Slovenia and the UK) have regulated lobbying to any degree and in many cases the implementation of lobbyist registers is severely lacking.
(iii) *Parliaments are not living up to ethical standards:* Important integrity safeguards which should be in place in parliaments, including mandatory codes of conduct for parliamentarians, clear conflict of interest regulations and rules on disclosure of interests, assets and income have not been instituted in many European countries, and where they are in place, practical implementation is often found wanting.
(iv) *Access to information is limited in practice*: Access to information laws are in place in all countries assessed apart from Spain, where a draft law is under consideration by parliament. However, in 20 of the 25 countries, implementation is found to be poor. Practical barriers to access include excessive fees (Ireland), long delays (the Czech Republic, Portugal, Slovenia, Sweden), low levels of public awareness of freedom of information laws (Germany, Portugal and Switzerland), lack of an independent oversight body (Bulgaria, Hungary and Latvia) and municipal authorities' failure and/or lack of capacity to comply with the rules (the Czech Republic and Romania).
(v) *High corruption risks remain in public procurement:* Legislative frameworks have been brought in line with EU procurement directives, but it is an open secret in many European countries that the rules are systematically circumvented and that this can be done with impunity.
(vi) *Protection for whistleblowers is severely lacking:* The vast majority of EU Member States have failed to introduce dedicated whistleblower protection legislation, in either the public or private sector.

Transparency International points specifically to the weaknesses in structures supposed to secure **political accountability**. This is a particular concern given the sector challenges and risks discussed in this briefing note. The higher the risk of undue political influence on regulatory decisions, the more difficult it is to secure market mechanisms and industry performance through award procedures. The new directive, focusing on how to fairly award concession contracts, should not lead us to forget how the general set of checks and balances matters for sector performance. The NIS methodology can be extended to include more specifically sector regulation and may thus provide information about the most relevant risks for individual Member States that seek to successfully implement the directive.

[23] Downloadable at: http://www.transparency.org/news/feature/enis

2.3.3. Third party monitoring of sector-political decisions

Given the sector characteristics, combined with the risks of undue influence listed in the previous section, third party monitoring becomes particularly important. However, while consumers might be quick to complain on high prices, they are often less qualified to assess the justification for high prices or low quality, and **external expert assessments** with access to information about contract details are critically important to secure a qualified response to weak performance (regardless of the reason) by independent watchdogs.

Industry performance can be assessed in different ways. Relevant information include how large part of the market is being served (cream skimming avoided?), the quality of the services (in line with promises/acceptable excuses?), and prices for different consumer groups. These industry indicators can be compared across countries and over time, and such comparison is clearly facilitated by harmonised principles for the award of concession contracts. However, given the risk of regulatory capture, it is important for outsiders to assess the procedural decisions as well. For example, the principles for award criteria may tell us much about contract design and the compatibility of incentives, but little about firms' influence on the choice of award criteria or auction method. The weighing of arguments and concerns in the process that leads up to the award of concessions might be useful to outsiders as well, and not only the technical details made public according to the proposal of the directive.

Considering network industries as example (since they are often regulated), Tables 3 and 4 (overleaf) list some aspects that should be carefully considered by independent experts (as part of third party monitoring): What characterises the sectors? How should they be regulated? Is there a risk that some players might accumulate too much profit at the expense of consumers? The details can be decisive in understanding where and how the sectors are exposed to unfair competition, and they must be understood by more actors than the firms and governments involved. Whether the characteristics of contracts and risk allocation are the result of undue influence *(ex ante)* or if there are structures that tend to provide better or worse opportunities *(ex post)* for unfair generation of rents is an important question that is rarely asked and even more rarely answered.

Table 3 details various opportunities for effective competition in different industries—and thus also various opportunities for firms to accumulate rents. Table 4 describes how risk and responsibilities are allocated differently in different types of contract (concessions considered one option among others).

Table 3: Sector characteristics, contracting, and rents: opportunities for effective competition in utility provision

	Electricity production	Electricity distribution	Toll roads	Water and sanitation	Telecoms
Economic characteristics	Rival, public good elements (environment)	Rival, network economies, natural monopoly	Nonrival, public good elements (land), natural monopoly	Rival, public good elements (health), network economies), natural monopoly	Rival, network economies
Political complexity of cost recovery	Medium	Medium	Medium	High	Low
Common contractual arrangements for private provision	License/service contract, concession, lease	Management contract, lease, concession	Concession	Management contract, lease, concession	License
Opportunities for rent extraction	Limiting competition, price setting, guarantees/ investment support, environmental and pricing regulation	Price setting, guarantees/ investment support, pricing regulation	Price setting, guarantees/in-vestment support, pricing regulation	Price setting, guarantees/in-vestment support, pricing and quality regulation	Price setting, spectrum license issuance/ terms

Source: Kenny and Søreide, 2008

Table 4: Allocation of responsibilities and risks in different contract types

	Management contract	Leasing contract	Concession contract	Private licensed provision	Private licensed (service) provision
Investment planning	Government	Negotiated	Negotiated	Private	Private
Capital financing	Government	Government	Private	Private	Private
Bearer of commercial risk	Mainly government	Mainly private	Private	Private	Private
Guarantee (supply price, political risk)	n.a.	n.a.	Frequent	No	Frequent

Source: Kenny and Søreide, 2008

For the same reason why we must understand the specifics of each deal to accurately assess the risk of influence as an obstacle to policy implementation, we also must learn more about the characteristics that may lead some players to exploit regulatory weaknesses or influence their terms unduly. In response to more attention to policy challenges, and armed with better data, researchers have stepped up their investigations of firm-specific determinants of undue influence. This is a welcome development and should benefit third-party monitoring bodies. For this to happen, not only data on performance has to be made available, but also contract details (considering the risk of collusion as the most important trade-off). Most **countries can improve significantly their contract transparency** (i.e. increase the list of details made available for the public). Under circumstances where details cannot be published widely, it should be made accessible at least to some independent experts (in addition to firms and government bodies), simply to secure careful assessment of the details from an independent perspective.

2.3.4. Do deviations from procedures result from corruption?

Although the effective undue influence of contractual terms will often be reflected in prices and service quality[24], we cannot automatically assume that high prices, low quality, contract deviation from economic recommendations and/or deviation from procedures for the award of concession contracts are the result of corrupt influences. This is consistent with the argument above about multiple goals; given the many different political concerns to be made it is difficult to tell if weak performance on some indicators is the result of political priorities, inability to predict the consequences of certain decisions, or some form of undue influence. We also have to accept that governing the sectors might be *difficult* – and sometimes outcomes are disappointing despite benevolent politics and regulation.

Identifying cases of undue influence is difficult also for an institution like the World Bank, which offers advice on sector regulation and finances huge projects. Some World Bank researchers recently conducted a study of the many indicators of uncompetitive behaviour, what they refer to in their study as “red flags” (Kenny and Musotova, 2011). While focusing specifically on World Bank construction projects, most of them in the water sector, they found on average two to three deviations from procedures and recommendations, the so-called “red flags,” in every project. Only very few of the projects with several red flags had been exposed to some form of corruption. Instead they concluded that these (very often) large projects are unique and complex in different ways that often justify some deviation from standard procedures. What they also found, however, is that there were cases of corruption where no “red flag” had been raised, i.e. there were no deviation from the procedures. In fact, in their limited set of observations, they found no clear correlation between the number of red flags and corruption. Accordingly, projects and award mechanisms can be subject to undue influence even if it looks like as if all rules have been respected.

[24] For discussion of determinants of sector performance and corruption, see Estache 2006, Estache and others (2009) and Seim and Søreide (2009).

3. IMPLICATIONS FOR THE PROPOSAL OF THE DIRECTIVE

The various sector and governance characteristics – and complexities – discussed in chapter 2, suggest that the political game might be *as important* for sector performance as the concession award principles. However, this should not at all be interpreted to mean that specific procedural principles governing the award of concessions contracts are irrelevant. What it means instead, is that to really make a difference in terms of sector performance, the procedural rules have to be protected by a broader set of integrity mechanisms and political checks and balances. Moreover, as underscored above, the risk of governance failure implies that some of the principles become even more important, particularly if well coordinated across Member States.

3.1. Important elements of a legal framework already in place

The impact assessment carried out by the Commission for the preparation of the proposal for the directive on the award of concessions contracts shows that rules and practices of Member States concerning the award of concessions are very different and that the principles of the Treaty are not understood and applied in the same way everywhere. This is also confirmed by Fritz, Rosenkoetter and Schmitz-Grethlein (2012) in a review of the legislative differences across the EU area, conducted for the debate of the proposal of the directive. In fact, some Member States have no rules on the award of concession contracts, including Germany, Belgium, Estonia, the United Kingdom, Finland, Greece, Ireland and the Netherlands.

3.1.1. Legislation relevant for competition in regulated markets

Whether the absence, at EU and some Member States' level, of this specific concessions legislation matters, and how much it matters, depends on a Member State's larger set of rules and legislation. The legal framework established specifically to or relevant for securing competition generally consists of several elements, as listed in Table 5. The importance and effectiveness of more legislation depends on how this larger set of legislation works.

Table 5: Elements of a legal framework against corruption

Undue influence / corruption	Legal approaches	
	Prevention	***Disclosure***
Decisions regarding private sector	Competition law, procurement rules, criminalisation of corruption, employer liability	Audits, leniency, whistle-blower protection, confidentiality rules, access to information laws
Undue influence at political level	Public lobby register, impartiality requirements	Media, watchdogs, whistle-blowers, auditors

In each Member State, different sets of rules have been adopted to address the different risks of undue influence or collusion for market benefit:

- Competition law is central to mergers, acquisitions, tacit collusion, unfair competition, and cartel cases. The cost side of the industries, which is important to match regulation with sector realities, is also covered by competition law given its multi-sectoral character.
- Administrative legal regulation that describes how various institutions are expected to control production safety and environmental standards. These regulations contribute to prevent firms from taking profitable shortcuts with potentially harmful externalities for the society at large.
- Illegal influence for market benefit will usually be covered by laws that criminalise corruption and by rules on employer liability.
- Lenience programs and whistle-blower protections are elements introduced to promote disclosure of illegal acts and may also have preventive effects.
- For regulatory decisions there are sector-regulation laws, ethical guidelines, and anticorruption rules, as well as requirements on impartiality that serve to prevent biased decision-making.
- Audit routines at different levels and established by law - complemented by various sophisticated controls - are elementary structures for uncovering fraud and corruption.

On top of the 'bricks' listed above, the political arena is regulated by constitutional law, registration requirements for lobbyists, and requirements related to impartiality; that is, a larger set of formal checks and balances. In addition, the political arena is scrutinised not only by auditors, but also by the media and watchdog groups. Members of politicians' staffs may blow the whistle if political decisions seem to have been steered by undue influence.

These elements of a legal framework established to prevent undue influence for market benefit are common in EU Member States. Their existence may easily be taken for granted, but this is an important mistake, because how well they function not only varies significantly across the countries; it also matters for fair competition in regulated markets. The different elements in the legislation contribute to *bolster* the procedures for the award of concession contracts.

The implementation process in Member States should consider not only the alignment and introduction of the new rules, but also how they have to rely on the other 'bricks' in the legal system for fair competition and welfare-enhancing use of market forces to the benefit of society at large.

3.2. The proposal of the directive - general concerns

Given current loopholes and risk of biased decision-making in the award of concessions, some form of initiative to strengthen the award processes in Europe is required. According to the public consultation organised by the European Commission, a third of participants (particularly businesses, associations, public authorities) were aware of cases of direct award of concessions, without any transparency and without competition. How should the concerns discussed in this note be dealt with by the proposed directive? And given the risks mentioned, what is the value of coordinating the legislation?

3.2.1. Minimum conditions for the political level

Well aware that the political environment influences the regulation of important sectors, we are not very good at listing minimum requirements for the political level – conditions that have to be in place for the new directive to work as intended. In fact, we tend to avoid the discussion because it obviously implies that some Member States have governments that may fail to respect the principles of the new directive. However, even if we agree that we don't want to close our eyes to what might happen at the political and sector governance level – it is far from straightforward how this concern *should* be addressed, given all options available. Social science tells us a lot about the importance of democracy, checks and balances, and separation of powers, but we *know* very little about the optimal sector-level (procedural) response to weak or unpredictable performance at the political level (Benitez et al., 2010).

What we can say for sure is that as part of the implementation procedures for the award of concession contracts, specific attention should be given (also) to the general set of integrity mechanisms – as mentioned above. The independence of the national competition authority and regulatory bodies, supreme audit institutions, complaint mechanisms and transparency in political processes – are preconditions for the law to deliver, and this should be underscored in the dialogue on implementation with the Member States.

Whether they should be mentioned explicitly by this directive is a different matter. There are other settings where these concerns are equally important and mentioning them in each and every law would add unnecessarily to the amount of EU legislation. Simply by addressing the risk of governance failure and undue influence on political decisions related to the regulation of these sectors and procurement processes, we contribute to reducing the risk. Some form of support to the third-party monitoring expert assessments, mentioned above, would contribute in this respect as well, and we should contribute to making violation of the articles and principles behind them more visible. Given the importance of integrity mechanisms for the law to deliver better sector performance, an assessment of relevant weaknesses in the set of checks and balances would be very relevant and useful for the Member States (for example by expanding the mentioned National Integrity Studies)

3.2.2. Why harmonise the legislation?

Specific legislation for the award of concessions matters as a counter-force against political pressure, as explained in Chapter 2. Even if award criteria can be influenced, and sector-governance decisions are subject to negotiations at the political level ('above' the procedural principles), the law serves as a minimum set of rules that have to be in place to secure benefits from market forces and efficient sector performance. At the same time, they enable the government to regulate the market through a set of conditions.

Clear legislation (in contrast to case law which is less readable for those without legal expertise) will **make deviation from the law more visible**. This will contribute to higher predictability, not only for consumers and citizens, but also for the players in the private sector.

For competition to work, firms that seek to enter a market must have confidence in the regulatory structures that the procurement law, the regulatory regime and property rights will be respected. This is important for markets to work well across and within Member States.

Harmonisation of the rules will emphasise these benefits. By contrast, continued variation across Member States would allow for different practices and interpretations. Given the complexity of several of the relevant sectors and the political issues discussed above, variation will make it difficult to detect and react upon undue deviation simply because fewer experts are there to assess the specific decision-making processes and outcomes. Coordinated principles will contribute to facilitate efforts of detecting harmful deviation from the rules across Europe.

Within the EU area today, there are different practices and legislation on the award of concessions and subsequent regulation, and there are different legal definitions and regimes across Member States. Concessions markets are covered by the general principles of the Treaty on the Functioning of the European Union (economic freedoms, non-discrimination, transparency, equal treatment, proportionality, mutual recognition), but in practice, there is a different application of these principles and interpretation. The proposed directive presents an effective step towards preparing for greater alignment and coordination. However, the legislation simply *initiates* the process of coordination; it is far from enough to secure coordination in practice. To achieve that goal, the implementation process must be taken seriously as well.

3.2.3. A plan for implementation should be in place *ex ante*

The literature on legal transplants tells us that for a law to be copied across countries, the implementation process must be taken seriously. What we have often observed, however, is that laws are copied from one country to another, as if simply the government's approval is enough to secure improved business performance. There is not much point in issuing the directive unless there is a strategy at the level of each Member State to secure that the responsible institutions learn how the law should be applied and why it will improve the life of individuals and framework conditions for industries.

Globally, 'pro-competition rules', procurement procedures, and anticorruption laws have been among the most copied elements of legislation over the last decade, and we have some empirical results on how well it has contributed to promote better sector performance[25]. Dutz and Vagliasindi (2000), for example, identify factors that seem to be decisive for the functioning of competition law in eighteen East-European economies. They find *institutional effectiveness to matter more* for the intensity of competition than enforcement and competition advocacy. Kee and Hoekman (2003) studied developments in 42 countries over 18 years. They found competition law to have *no direct impact on industry markups*; the indirect effects of entry conditions were stronger. Reduction of trade barriers also seemed to matter more for fair competition than the competition law itself. Djankov and others (2003) found civil law countries (especially the Nordic) to have stricter regulations on entry, lower enforceability of contracts, more challenges with corruption, and a less fair legal system.

[25] Several of the mentioned elements of the legal framework function differently in different countries. See, for example, the Civil Law Convention on Corruption (Strasbourg. 4.XI.1999), particularly on whistle-blowing and compensation for damage.

Nevertheless, while legal tradition appears to matter, Lee (2005) found that the enforcement of competition law was *not* determined by legal tradition. The process of implementing the law mattered more than the details in the law[26]. Lee's result is supported by that of Berkowitz, Pisthor, and Richard (2003), who claim that the success of a legal reform strategy depends on "how the meaning is understood and purpose appreciated by domestic law makers, law enforcers and economic agents, who are the final consumers of ... the rules." For competition in network industries, these insights are supported by Estache and Martimort (1999). According to them, a closer look at how the larger institutional framework works reveals that the internal organisation of the government and the functions of the legislative and the executive seem to matter decisively in the implementation process, sometimes eclipsing in importance the details of regulations, anticorruption procedures, and competition targets.

These results tell us that the new directive will be a great **step towards better sector performance *only* if implementation is taken seriously**. Apparently, the law is very likely to function differently in different countries, depending on a complex set of factors at the national level, including legal culture, underlying conditions related to checks and balances, the quality of institutions, and the function of democracy[27]. What we also learn from these results is that the process of implementation can be *employed for strengthening the most relevant institutional framework conditions*. This alone, if done well, would justify the new directive and it should definitely be planned for at the stage of drafting and signing the directive.

3.2.4. Prevention and reliance on self-regulation

Tools for industry regulation are constantly in development, not only when it comes to the award of concessions. In recognition of increasingly complex market realities and limits to bureaucratic omniscience, firms are now expected to 'regulate themselves' in several areas. Self-regulation has become common in quality and safety standards, for example. The trend we have seen over the last decade – with the introduction of ethical standards at all levels of management decisions – suggests attempts of self-regulation also when it comes to preventing the exercise of undue influence for market benefit. Is this something we can rely on in order to avoid the kinds of market-and governance failures discussed above?

There are different categories of self-regulation, including (i) *voluntary* self-regulation, which is often expressed in corporate governance codes; (ii) *statutory* self-regulation, which might be referred to as metaregulation (or semi-self-regulation), in which internal control regimes are required by law and firms provide information that is publicly controlled; and, (iii) *indirect statutory* self-regulation, which is not required by law although the law rewards companies that embrace it. As an example of the third category, employers with internal control systems established to prevent corruption may not be liable for damages caused by the corrupt behaviour of their employees.

[26] Lee (2005) offers a broad review of the empirical literature on this area and discusses mechanisms mentioned here in more detail.

[27] Common law countries (United Kingdom, United States), which are often perceived more conducive to business, share significant differences from civil law countries (Nordic, German, French, continental Europe), which exhibit greater variation in their law traditions. For example, there may be important differences in the independence of the judiciary from the executive and legislative branches, the ability to have a case considered in light of the principles behind the law, the predictability of written rules, the procedures for evaluating a competition case, the professional status of judges, the cost (to judges) of false conviction versus false acquittal, and in the use of appeals and relitigation.

Although such regulations may well promote fair competition in a market, they may also be fraught with incentive difficulties. By instinct, economists are **sceptical of self-disciplinary ethical rules**, suspecting them to be little more than a cover for hidden profit-seeking actions, particularly where firms can lower their exposure to sanctions by adopting ethical codes of conduct[28]. In finance, however, studies have been done of the factors that make corporations more or less reliable in the matter of self-regulation - see Toffel and Short (2011) for recent results and literature review. The question of government responsibility vis-à-vis self-regulation, which is on the agenda in several areas, then becomes a matter of firms' internal organisation and incentive schemes. Similarly, the effectiveness of reward systems, for example, for companies that speak out about their own corruption to obtain leniency, may also depend critically on characteristics of the firm and the sector.

This is an area where the set of recommended policy-options are in rapid development, both in terms of policy experiments and research on what works. Until we know more, self-regulation should not be embraced uncritically in markets regulated with concession-contracts. If managers can avoid legal sanctions on attempts of undue influence by claiming for example that "we did everything we could to avoid involvement in corruption" and thus avoid sanctions, the self-regulation schemes may increase the risk of undue influence. Those responsible for the new directive should be aware of corruption risks and laws in general, and particularly the developments in rules established to prevent market players from offering bribes. On other areas, new developments in self-regulation may reduce the need for comprehensive concessions details and may well reduce the need for control. Nevertheless, self-regulation is no silver-bullet when it comes to avoiding undue influence, and randomised controls from the side of governments might be critical for self-regulation to 'work'.

3.2.5. Disclosure and incentives to speak out about violations

The many risks of unfair competition in regulated sectors — and of hiding undue influence, legal or not, underscore the importance of whistle-blower mechanisms — for preventing as well as exposing crime. Those in positions to understand how decisions have intentionally deviated from welfare targets should be encouraged to speak out and should be protected against the consequences they may face. While whistle-blower mechanisms and protections are common features in criminal law, the implementation of such regulations has been challenging. Several OECD evaluations of the performance of convention-based, cross-border anticorruption legislation, for example, point to weaknesses in how anticorruption legislation is supported by whistle-blower protections and how those weaknesses may undermine the legislation.[29]

Despite attention to their importance, whistle-blower statutes may not work as well as they might to promote disclosure of undue influence, and individuals who blow the whistle may be doomed to lose their case in court. Opposing big corporations, whistle-blowers are exposed to power and resource imbalances and will often lack sufficient protection as the conflict escalates.

[28] See Rose-Ackerman (2002) for a related discussion.
[29] See also the mentioned National Integrity Studies organised by Transparency International, referred to above. Whistle-blower protection is generally too weak in Europe.

Poor insight into conflict theory and organisational behaviour on the part of the lawyers in a court adds to the challenge for the whistle-blower, because he or she may be put into the position of having to explain corporate actions as parts of a scheme to damage the whistle-blower's reputation.[30]

Firms, in contrast to individuals, may act as whistle-blowers if victimised by unfair competition. They may not be exposed to the same resource imbalance, but their tendency to speak out — for example, if competitors have won contracts through corruption — is nevertheless very low. The reason is not only the lack of proof in most such cases. Firms will be concerned about reactions in the market if they complain about a competitor, and they may worry that a complaint may harm their chances to win contracts from the same or other customers. Although there have been developments in liability claims for contracts lost because of corruption — in addition to procurement procedures that encourage whistle-blowing — the actual tendency to speak out is likely to depend on the firm's market position, its trust in the legal institutions to pursue the allegation, the political environment, and how a charge of unfair competition will be perceived at that level (Søreide, 2008).

In contrast to whistle-blowing, leniency programs have been introduced in many countries (globally) to encourage those who are themselves involved in economic crime to speak out and get a lighter sentence as a result. Experiences from the United States have encouraged European countries to introduce leniency programs to prevent and disclose cartel collaboration. Brenner (2009) finds these programs to have important effects in Europe. The duration of investigations in cartel cases, for example, is reduced by 1.5 years on average. As suggested by Spagnolo (2004), however, the effect of leniency programs depends critically on how the program is designed. The "steeper" the program, in terms of reduced sanctions for those who speak out, the stronger is the "run to the courthouse" effect. Spagnolo predicts that moderate programs can be counterproductive, while "courageous" programs will be highly efficient.[31]

In general, rules 'can more safely be violated' if nobody dears to react, and for this reason, the **function of whistle-blower mechanisms and leniency programmes** are highly relevant for the new directive for the award of concessions.

[30] In Norway (author's home country), for example, where the legal framework to secure fair competition is well-developed and based on international trends, there have been about 20 cases in which a whistle-blower has spoken out against a corporation. The whistle-blower has won in just one of the cases.

[31] Before leniency programs can be safely imported from another system, we need a better understanding of how any such program depends on specific legal traditions and institutions. The same program may work very differently in a country where the legal institution that offers leniency is able to offer reduced sentences only for cartel collaboration (civil law systems, typically), than in one where the legal institution can offer to reduce penalties for a combination of offenses. In the first case, the cartel might be expected to respond to a leniency program by getting members involved in other types of crime, such as corruption, that may have the additional effect of facilitating the cartel, thereby hampering the effect of the program, since cartel members would still risk sanctions even if they reached a deal with the authorities on cartel collaboration. Players' likely response to legal amendments and programs in different environments are relevant to understanding why the effect of pro-competition legislation may differ across countries. Søreide and Eriksen (2012) investigate Norwegian law and its ability to form the basis for prosecution of the coexistence of corruption and collusion.

3.3. More specific concerns

This briefing note was not meant to be a *legal* assessment of the proposal of the directive. Some comments to the specific articles are nevertheless included in this section.

3.3.1. Important principles already well addressed by the proposal

The proposal of the directive already includes important elements to prevent corruption and collusion, including publication of tenders and deadlines, definitions, approval of participants, rules for the tender procedure, and technical specifications. The drafted rules underscore the importance of tender criteria listed and ranked ex ante (Article 32 and 39), as well as the need for clear and predictable conditions for renegotiation and prolongation of contracts (Article 42 and 43).

The set of rules is consistent with international best practice recommendations. While it seems to address most important aspects of procurement, a pertinent question might be if it has become too comprehensive. In contrast to common beliefs, more rules and less discretion are not necessarily the key to avoiding corruption and collusion. The main benefits of harmonisation can be obtained by keeping some core principles and rules equal across the Member States. And then, clear allocation of responsibility might be much more important than more details. Specifically, those who make decisions ex ante award should – in one way or the other – be faced with a **responsibility for the ex post outcome** in terms of sector performance of the award process. At least, those who seem to have made weak decisions should be relieved from such responsibilities (even if obvious, this is not necessarily what happens in practice).

Assuming the mentioned risks of governance failure, a combination of simple principles for the award of concession contracts and a comprehensive check on overall accountability mechanisms might be more efficient than a comprehensive set of award procedures alone. Moreover, implementation is also much easier (and convincing) for a set of simple rules than for a very comprehensive one.

3.3.2. Specific details that may benefit from some more thought

In addition to what has been discussed above, some specific concerns might deserve more attention:

- The risk of **corruption and tacit collusion *combined*** may have to be addressed explicitly. In most European countries, investigation of collusion will be part of competition law enforcement – and enforced by an institution that focuses primarily on violation of competition law. Corruption, however, is a criminal offence, and the collaboration between competition authorities and criminal law enforcement bodies may have to be improved in some countries to avoid the combination, which is difficult to identify unless it is searched for. For example, if leniency is offered to reveal cartel cases, the firm involved may avoid to have its involvement in corruption investigated – because it is a 'competition law case'.
- In countries where corruption is a significant problem while there is still some expectation that the law will be respected, the **rules of exception** are particularly exposed to misuse (or 'over-use'). It is very important that the reference to exceptions are not only well justified; the cases should also be subject to some form of ex post assessment.
- The proposal of the directive goes far in securing transparency. However, as indicated in the discussion above, the options for **independent control of contractual terms and performance** might need to be strengthened. The private sector will often accept expanded transparency (as long as some specific details are protected).
- The resistance is more likely to come from the state administration, which face the risk of being held accountable in cases of governance failure. Most countries can go further in securing contract transparency, without increasing the risk of tacit collusion.
- While the rules should include some form of reaction to firms that have been involved in collusion, corruption, or other forms of business-related crime, art. 36 – the way it is formulated – might be too strict. According to that article, firms that have been involved in something illegal will be debarred with no clear time limit. The firms might have been found guilty and convicted for its offence, and will nevertheless be debarred – possibly forever. Hence, while some form of reaction makes sense, they should not be totally eradicated. Besides, some of these markets are oligopolies, meaning there are already few firms involved in the competition. Removing one of the competitors will easily lead to somewhat higher prices for consumers. Moreover, a complete debarment means that we cannot buy the services from the given firm, and this might pose a problem, if the firm offers unique technology and the services are actually needed. In order to avoid 'pragmatic case-by-case interpretation of the law, a somewhat **modified version of the debarment clause** might be needed. It should also be considered if and when it might be sufficient to debar only the individuals involved in collusion and/or undue forms of influence, instead of punishing the company as a whole.

4. CONCLUSION

This briefing note has described the risk of undue influence, corruption and collusion on sector-governance decisions and the award of concession contracts. We have seen how state intervention to reduce *market* failure easily creates a risk of *governance* failure, and this concern must be addressed to secure the intended combination of market forces and sector regulation – as is ideally offered by concession contracts.

Harmonised EU legislation specifically on the award of concession contracts is an important step to reduce the mentioned risks, particularly because it will make undue influence on these markets more visible across Member States and develop a common understanding of how to best secure 'value for money' for consumers and citizens.

However, the impact of the new rules on the award of concession contracts will depend not only on how carefully they are implemented, but also the quality of a broader set of integrity mechanisms within the respective Member States. Hence, while the law is an important step towards securing efficient regulation, we need checks and balances on the many decisions that are still within the reach of politicians and civil servants with sector oversight responsibility.

Although this paper lists a number of serious risks that are difficult to remove completely by a set of procedures, it supports the proposed directive. The draft reflects solid understanding of international best practice, yet some specific recommendations are listed:

- Government representatives involved in sector-regulation and award procedures should be held responsible ex post and excluded from decision-making if there is suspicion of bias.
- There is serious risk that corruption and collusion are combined and thus difficult to reveal by institutions focusing on only one of the challenges (i.e. competition authority and financial crime unit).
- Rules of exception are at particular risk of being manipulated and there may be a specific need for ex post justification and control when those are applied.
- Contract transparency should be applied as far as possible and independent control by (independent) sector experts should be facilitated (while independent regulatory agencies are supposed to serve this role, additional controls are needed to reduce the risk of regulatory capture).
- The reaction against firms that have already been involved in some form of illegal practice for market benefit may have to be reconsidered. It should not eliminate firms that have already been penalised for some offense. It might be sufficient to pursue a stricter responsibility of individuals involved in collusion and/or undue forms of influence, instead of punishing the company as a whole.
- The trade-off between comprehensive rules on one side and discretion combined with clear allocation of responsibility depends on the general set of integrity mechanisms in society. Transparency mechanisms should be further strengthened where possible.

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