

# ANTI-CORRUPTION HELPDESK

PROVIDING ON-DEMAND RESEARCH TO HELP FIGHT CORRUPTION

## COLLUSION IN PUBLIC PROCUREMENT CONTRACTS

### QUERY

What are the best international practices to avoid collusion in public procurement contracts?

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### SUMMARY

Public procurement constitutes a large part of OECD countries' public spending. Due to the large sums of money involved, it can often fall victim to fraudulent activity such as collusive behaviour. Collusion between firms reduces fair competition and efficiency during the bidding process. It damages the economy by artificially inflating the prices paid for services and goods.

International institutions such as the OECD, World Bank and the World Trade Organisation have made several recommendations for actions to be implemented to prevent and penalise collusive behaviour. These include measures against colluding firms such as: the tender design, transparency throughout the bid, a collaborative network of experts, and dissuasive sanctions such as debarment and monetary fines. These combined measures are expected to have a successful effect in tackling illegal appropriation of funds and markets.

## 1 OVERVIEW OF COLLUSION IN PUBLIC PROCUREMENT

### Background

Public procurement involves large sums of money that is used to fund goods and services for public projects. In OECD countries, public procurement accounts for more than 15 per cent of gross domestic spending, meaning that the amount of funds in danger of being lost through collusion could have an immense impact upon the economy (OECD 2010, 23).

Competitive markets are necessary because they ensure that public funds are used effectively through giving companies an incentive to improve production and efficiency, to adopt better technology and to innovate (Godfrey 2008, 4). Conversely, anti-competitive behaviour can be detrimental for democracy, sound public governance and economic development (OECD 2010, 10). Collusion ultimately results in funds that should be used to the benefit of the public ending up in the pockets of individuals and colluding firms.

The OECD refers to collusion as “a relationship between bidders which restricts competition and harms the public purchaser” (OECD 2010, 24). For example, firms may conspire to rig the bids and determine who should win the tender. They may do this through arranging their bids through bid rotation, complementary bidding, or cover pricing to appear competitive to the authorities (OECD 2010, 9).

For example, in 2009 the UK Office of Fair Trading imposed fines of £129 million (€152.6 million) on 203 firms in England after these firms were found to have colluded with competitors to agree on over-inflated bids for building contracts for the National Health Service and schools (National Fraud Authority 2011, 8).

### Collusion and corruption

While collusion and corruption both negatively affect public spending, they are two distinctly different illicit activities. Whereas collusion is the horizontal relationship between bidders, corruption involves a vertical relationship between bidders and a public official (OECD 2010, 24). This is a principal-agent problem whereby the agent (the procurement official)

enriches himself at the expense of his principal (the general public) (OECD 2010, 24). This may involve the official designing the procurement process or altering the outcome of the process to favour a particular firm in exchange for a bribe or gift (OECD 2010, 24).

However, collusion and corruption are closely interrelated and can be mutually reinforcing. They can occur simultaneously, for example, when public officials are bribed to turn a blind eye to collusive tendering patterns or to release otherwise withheld information that facilitates collusion (Anderson, Kovacic 2009, 68). Detection of this behaviour can also be hindered when collusion is associated with corruption (Tóth et al. 2014, 3) as procurement officials are complicit in the illegal activity.

For prevention it is essential to understand the mutually reinforcing effect that these activities have upon each other. Collusion comes within the remit of a competition authority while corruption is pursued by public prosecutors or anti-corruption agencies (OECD 2010, 11). Some may go as far as to state that these two issues are rightly addressed separately, and that together they are insufficient to bring about efficient government spending (Ohashi 2009, 284). This is because their different approaches may seem incompatible.

Nonetheless, analysis from experts routinely concludes that to be successful, collusion and corruption should be investigated conjointly (Lambert-Mogiliansky, Kosenok 2009, 99-111). This approach is supported by institutions such as the OECD (OECD 2010, 11). The mutually reinforcing effects of corruption and collusion means that the institutional separatism between the jurisdiction of competition authorities and that of the criminal courts must be overcome (Lambert-Mogiliansky, Kosenok 2009, 99-111). Therefore, to attain effective public procurement, the two issues must be addressed together.

### Factors driving collusion

There are a number of factors which facilitate collusive activities between firms. These involve a number of market conditions and the nature of public contracts, for example:

- regulatory requirements in public procurement which render the process predictable

- the sheer quantity of goods and services contracted by the state makes monitoring bidding patterns difficult
- transparency of commercially sensitive information: this may allow bidders to align their bidding strategies and monitor bid rigging cartels (OECD 2010, 10-11)
- small number of bidding companies: the fewer the companies, the easier it is to collaborate
- little or no entry: when few businesses enter or are likely to enter a market because it is costly, slow, or hard to enter, which protects the market from the competitive pressure of new entrants
- industry associations: these may be subverted to anti-competitive purposes and may be used by company officials to meet and conceal their discussions
- repetitive bidding can help members of a bid-rigging agreement to allocate contracts among themselves
- identical or simple products or services makes it easier for firms to reach an agreement on a common price structure
- little or no technological change or few substitutes means that agreements are easier to reach and maintain (OECD 2012, 7)
- bid suppression: involves agreements in which companies agree to refrain from bidding
- bid rotation: firms agree to take turns being the winning bidder
- market allocation: when firms agree not to compete for certain customers or geographic areas (OECD 2012, 4)

### *Tacit agreements*

Tacit agreements often take place in markets that inhibit the previously mentioned factors that help facilitate collusion. Unlike cartels, tacit agreements are not formal arrangements between firms but rather are agreed practices in a market that are not necessarily communicated or written down.

This has the same outcome as explicit collusion and may resemble a cartel, but is instead a result of the influence of a dominating firm or opinion within the market (Ivaldi et al. 2003, 4-5). This could mean that a price leader sets the general price for the industry and other firms follow suit. It is much more problematic to prove that tacit collusion has taken place as there is often no hard evidence of communication.

### *Bid-rigging red flags*

The World Bank provides a list of red flags that can indicate bid rigging has occurred. These may also signal that corruption has also taken place. They include:

The most common form is explicit collusion, which is commonly carried out through a cartel. A cartel is formed when firms involved in the same market conspire and decide to seize the market and funds. The principle objective of cartels is to raise the price of goods or services or to control the market through anti-competitive means.

The establishment of cartels is typically prohibited by anti-trust laws. The activities cartels can carry out to appropriate markets involve bid-rigging schemes, as detailed by the OECD:

- cover bidding: when firms agree to submit bids that are either higher than that of the designated winner, submit a bid that is known to be too high to be accepted, or a bid that contains terms that are known to be unacceptable to the purchaser
- any complaint from bidders or other parties: upon investigation, these often lead to the discovery of fraud and corruption
- bids are distinct from one another by a systemic percentage, for example, 1 per cent or 3 per cent differences
- bids are too close or too far apart
- losing bids are round or unnatural numbers
- unexplained inflated bid prices
- losing bidders become subcontractors
- apparent rotation of winning bids
- repeat awards to the same contractor: this may also signal corruption (Integrity Vice Presidency no date)

Further information can be found at: <http://pubdocs.worldbank.org/en/324351449169329391/Red-Flags.pdf>

## 2 RECOMMENDATIONS TO DETER COLLUSION

### Background

#### *International instruments*

International bodies set out broad recommendations and instruments for states to discourage anti-competitive behaviour. The UN Convention against Corruption states that each party state shall take the steps to establish appropriate systems of procurement based on transparency, competition and objective criteria in the decision making process (UNCAC 2004, 12). Similarly, the OECD Convention on Combatting Bribery of Foreign Public Officials states that parties should implement transparency in public procurement while adhering to relevant international standards such as the WTO Agreement on Government Procurement (OECD 2011, 25).

The WTO agreement is an international legal instrument which sets out guidelines on how public procurement processes can avoid issues such as collusion and corruption through the implementation of transparent and non-discriminatory conditions of competition (Anderson and Kovacic 2009, 73).

In 2009, the OECD Competition Committee developed a methodology to help governments fight against bid rigging in public procurement. The OECD Guidelines for Fighting Bid Rigging in Public Procurement help officials to reduce the risks of collusion through design of tender process, and for detection through warning signs and patterns. For more information: <http://www.oecd.org/competition/cartels/42851044.pdf>

### **Collaboration between competition authorities and anti-corruption bodies**

#### *Competition authorities and anti-corruption agencies*

At the national level, nearly every government and development agency has specific investigative bodies, such as competition authorities whose role is to deter and sanction colluding firms (Tóth et al. 2015, 3). Competition authorities are government agencies who regulate and enforce competition laws. Corruption is often targeted by anti-corruption agencies, which are often independent of government. The OECD

recommends that the two work together to achieve sound public procurement (OECD 2010, 11).

There may be some conflict between the different approaches of the two bodies as some anti-corruption measures may have an adverse effect on competition through giving firms the opportunity to collude. For example, although transparency can discourage corruption, excessive information could facilitate collusion between firms. To alleviate the tensions between the two, an agreement between the groups should be established stating to what extent and which form of data should be made publicly available (OECD 2010, 11).

Similarly, small and regular tenders are likely to facilitate collusion, whereas they are considered the best practice to deter corruption (OECD 2010, 11). The OECD expresses the necessity of sound procedural designs, such as those used in moderating the different approaches of competition authorities and anti-corruption agencies (OECD 2010, 11).

For best practice rules in public procurement to be developed and enforced, the literature supports having a collaborative policy for the relevant authorities at all stages of the system.

The OECD criticises the fact that, in many countries, the enforcement of anti-trust laws through competition agencies are entirely unrelated to the enforcement of anti-corruption which is delegated to the judiciary or anti-corruption body (OECD 2010, 31). Instead, the OECD endorses a strong working relationship between competition, corruption and procurement authorities (OECD 2010, 31).

A best practice example of a competent collaborative system is the Competition Commission of Singapore, which recognises that collusion and corruption can occur together. The Competition Commission therefore maintains a close working relationship with the Corrupt Practices Investigation Bureau and they have an established protocol which addresses case allocation and administration between the two agencies (OECD 2010, 30).

#### *Network of experts*

National and international networks of experts from competition authorities, procurement administrations,

and public prosecutors are important. These create a flow of information which improves detecting both corruption and collusion and best practices on their prevention (OECD 2010, 28).

An example is the Chilean Competition Authority which established an Interagency Taskforce for Fighting Bid Rigging. This includes representatives of the independent body in charge of the legality of the administration's actions, the E-Procurement Bureau, the Ministry of Public Works, the Council for the Internal Auditing of Government, and an association of officers and staff in charge of procurement areas of different public bodies (OECD 2010, 30).

The European Union has also formed the Network of Competition Authorities. It permits all competition authorities within the network to work equally with one another and make the management of information as efficient as possible by exchanging it throughout the system (ECN 2003, 1-2). Most importantly, it has established an arrangement within which competition authorities, courts of member states, and the commission are all in direct communication with one another (ECN 2003, 1). The network also arranges for groups of specialists from different sectors to regularly meet and discuss competition problems in order to promote a common approach.

## Development of best practice rules for public procurement

### *Design of the tender process*

The design of the tender process affects the ability of firms to collude with one another. A successful tender design will ensure that there is fair competition between honest firms. There are various ways to achieve this, depending on the result of a risk assessment and whether the tender will be more susceptible to collusion, corruption, or both.

#### **Open tender**

For instance, if there is a risk of corruption, then a dynamic (or open) tender is preferable. This is when bidders gather at the same time at the same location to submit multiple bids, with the best being awarded the public contract (OECD 2010, 27). These are desirable for anti-corruption efforts as these bidding systems offer fewer opportunities for procurement officials to favour one firm over another (OECD 2010,

27). However, this process can facilitate co-ordination among firms as they can monitor each other's bids and their agreed contract allocation (OECD 2010, 27).

#### **Sealed-bid tender**

Therefore, if collusion is the greatest risk, then a sealed-bid tender is the safer option. A sealed-bid tender involves each bidder submitting one single offer, and the bid is kept secret from other bidders (OECD 2010, 27). Clarification meetings and on-site visits should be limited in favour of remote procedures where identities are anonymous (OECD 2012, 3).

The World Bank also recommends encouraging smaller firms to bid for segments of the contract to facilitate more competition (World Bank 2011, 21). This prevents collusive activity and reduces the opportunities for firms to communicate with one another and conspire to rig the bids. However, the absence of transparency in the sealed-bid tender process may make it open to corruption.

If there is a high risk of both corruption and collusion occurring, then the OECD recommends that a sealed-bid tender be used, but make it "corruption proof" through the use of online bidding systems that ensure there is a record of each bid and who had access to the information (OECD 2010, 28). E-procurement also ensures that the procurement process is swifter, which reduces the amount of time available for procurement officials and firms to communicate and build trust with one another. E-procurement is increasingly used throughout the globe for public tenders.

Another technique to reduce the amount of time involved is to qualify firms during the procurement process, rather than before (OECD 2009, 5). This also allows identities to remain anonymous for longer and reduces the uncertainty of the number of bidders (OECD 2000, 5).

### *Transparency*

While most agree that transparency reduces the opportunity for corruption in public procurement, unnecessary transparency can be inconsistent with the need to ensure maximum competition between firms (OECD 2010, 11). Data on the capability and identity of firms early in the bidding process means that cartels may be able to form, while transparency during the bidding process may allow firms to monitor

other members' commitment to the cartel agreement, or if not, when to exert a penalty. It can be particularly problematic in highly concentrated markets when increased transparency enables tacit collusion as companies can predict the conduct of their competitors and then align their own behaviour to it (OECD 2010 26).

Yet the relationship between collusion and corruption necessitates transparency in the procurement process. Transparency limits corruption in public procurement by allowing stakeholders to monitor the behaviour of procurement officials, which increases accountability and lowers the discretion of the officials.

In support of transparent bidding, an independent external study for the European Commission found that increased competition and transparency between 1993 and 2002 generated savings of €5 billion to €25 billion for member states (Anderson, Kovacic 2009, 71). Similarly, another analysis reveals that improved transparency reduces procurement costs by up to 8 per cent (Ohashi 2009, 267).

Organisations such as the OECD, WTO and the World Bank all commend specific levels of transparency in public procurement. The WTO Agreement on Government Procurement advocates for more transparent rules in international public procurement (WTO 2014). The World Bank requires from borrowing country governments that tenders be conducted transparently (World Bank 2011, 13), yet cautions procurement staff to consider carefully which information about the tender should be released (World Bank 2011, 20).

Similarly, the OECD clarifies when transparency is useful and when it should be restricted with caution during the tender process. It states that bidding procedures should not provide the participants with sensitive information on the actions of others and instead allow for review of decisions by independent public agencies (OECD 2010, 11).

It is specified that there should be the clear and precise disclosure of requirements for types of information, such as only information on the winning bid be released, identities kept anonymous and that the disclosure of sensitive information be delayed to ease effects of collusion (OECD 2010, 26-27).

## Preventative measures

### *Education*

Education of public officials, private business and the wider community is central to avoiding collusion. The OECD recommends that the use of guidelines and best practices are particularly useful in this area, and a multidisciplinary approach can secure significant results (OECD 2010, 29).

Regarding the education of public officials, the WTO regularly invites officials to attend training seminars and workshops on government procurement, which are presented by the WTO Secretariat and typically include a module on the detection and prevention of collusive tendering (Anderson, Kovacic 2009, 88).

The OECD also recommends that officials involved in the bidding process attend regular briefings and programmes to understand the penalties for collusion and corruption (OECD 2010, 31). Records of historical information is particularly important for informing officials, and the OECD mentions that, to monitor bidding patterns, information about the characteristics of past tenders must be stored and periodically reviewed to try to discern future suspicious patterns (OECD 2012, 14).

Education of firm employees involve similar methods to that of public officials. These should deter, if sanctions are correctly enforced, individuals from indulging in collusion as knowledge of the penalties should reduce the incentives.

Averting collusion also relies on an informed public. Competition authorities should reach out to the public with educational programmes giving information on what is permissible and what is not. A best practice example comes from the US Department of Justice (DOJ), which trains staff in all of the state agencies around the United States on various types of fraud (Abrantes-Metz 2013, 3). The DOJ educates these staff on the red flags for collusion, including identical prices, unexplained price increases and elimination of discounts (Abrantes-Metz 2013, p.3): patterns that are easily recognised without specific expertise. This helps to raise awareness of the general patterns of collusion and enables individuals outside of competition authorities to be able to raise concerns over collusion.

### *Internal compliance*

The education of business employees also includes putting in place internal compliance mechanisms to deter employees' engagement in fraudulent behaviour. The OECD endorses that the tender notice requires the condition that firms adopt compliance programmes prior to bidding (OECD 2010, 31).

Although some of the literature argues that compliance training alone is not sufficient to deter collusion, it can give a corporation an advantage in deterring illegal behaviour before it has even begun (Abrantes-Metz 2013, 10-11). It has been recommended that, to further improve the competence of corporate compliance mechanisms, incentives can be given to firms to implement these programmes (Abrantes-Metz 2013, 11).

There are various ways for companies to introduce internal control mechanisms. They can set up an audit committee, consisting of various independent stakeholders and shareholders, which evaluates the company's programmes and controls. The audit committee must maintain healthy levels of scepticism in the firm's activities to remain truly independent (Bell 2010).

The group can produce a fraud risk assessment to identify the risks that management may be facing as well as the likelihood of illegal behaviour. Other methods of compliance could include whistleblower hotlines and training to deter and educate employees on the risks of colluding.

## **Enforcement action**

### *Leniency programmes and whistleblowing*

Incentives to expose illegal behaviour is fundamental to the prevention of explicit and, to some extent, tacit collusion, and this comes in the form of whistleblower hotlines and leniency programmes.

### **Whistleblowing**

Whistleblower programmes involve individuals who are not directly involved in colluding but have valuable information and are prepared to expose the misconduct of others. The World Bank recommends that incentives such as granting immunity to witnesses or financial rewards to compensate employees who

may suffer as a result of their evidence (World Bank 2011, 20). For example, the Securities and Exchange Commission of the US is authorised by Congress to provide monetary rewards to whistleblowers ranging from between 10 per cent and 30 per cent of the money collected from the offending body.

### **Leniency programmes**

Leniency programmes encourage cartel members themselves to come forward and assist anti-trust authorities in investigating and prosecuting their fellow cartel members. In exchange, they receive amnesty for their own behaviour (Anderson, Kovacic 2009, 83).

Leniency programmes have been adopted in the United States in the 1980s and by the European Commission through the 1990s, developed through the European Competition Network (Anderson, Kovacic 2009, 83). Leniency programmes are considered an effective way of deterring collusion, as insiders are in a good position to provide the type of evidence needed to prove a violation of the law, and communication between cartel members leaves considerable traces (Aubert et al. 2003, 3). However, financial incentives can be considered to strengthen the prospect of providing evidence.

Leniency programmes have resulted in numerous investigations into various industries, with billions of dollars in corporate fines as well as the incarceration of several corporate executives (Abrantes-Metz 2013).

### *Data analysis tools*

Data analysis is a means of observing patterns and discerning whether collusive behaviour has or will happen, and is a key tool of competition agencies in prosecuting offenders. The OECD checklist indicates the warning signs and patterns to be aware of when businesses are submitting bids, such as: the winning bidder subcontracting work to unsuccessful bidders or some supplier unexpectedly withdrawing from bidding (OECD 2009, 12). These patterns are easily recognisable and may not need in-depth training to detect. However, to discern more certainty in collusion claims, economic experts have a role to play. The tools used in their data analyses are commonly referred to as "screens" and have the ability to flag illegal activity through economic and statistical examination (Abrantes-Metz 2013, 2).

With the rise of “Big Data” (large data sets, including electronic records of historical bidding patterns) analysis of large volumes of data can now be quantitatively studied. Data from current and previous bids can be amalgamated and questioned to detect whether collusion has happened and where it is likely to occur in the future. Screens can be used in combination with traditional qualitative investigative methods and, when combined, significantly enhance detection rates (Tóth et al. 2014, 3).

The data experts commonly use are: risk indicators that are expected to signal collusion, benchmarks of “healthy” markets, alternative explanations of these patterns and then assigning collusion risk scores where markets are allocated to either a no risk or risky category (Tóth et al. 2014, 8).

It is maintained that screens will enhance deterrence because individuals will be aware that their behaviour is being monitored and will thus discourage engagement with a collusive behaviour (Abrantes-Metz 2013, 18). Although some argue that colluders in cartels could manipulate their behaviour to avoid detection from these screens, this in itself may prevent market manipulation. This is because, to increase members’ profits, a cartel must have some impact on the market, and therefore will be detectable (Abrantes-Metz 2013, 19).

### *Certificate of independent bid determination*

A certificate of independent bid determination is another tool which is useful to those prosecuting colluding firms or individuals. These may be a requirement of firms to complete before the bidding process. They entail each bidder to certify under oath that they have not agreed with their competitors on bids nor attempted to rig the bids in any way (OECD 2010, 30). These are important tools for prosecutors as they allow firms to be indicted for not only collusive behaviour but for the criminal penalties of filing a false statement to the government, which is significantly easier to prove (OECD 2010, 30).

For example, before the World Bank funds a project, it needs companies to meet the following requirements for a certification of independent bid determination:

- the prices in the bid have been arrived at independently without any consultation,

communication, or agreement with any other bidder

- the prices in the bid have not been and will not be disclosed by the bidder, directly or indirectly, to any other bidder before bid opening
- no attempt has been made or will be made by the bidder to induce any other firm to submit or not to submit an offer for the purpose of restricting competition (World Bank 2011, 24)

An example of a Canadian Certificate of Independent Bid Determination can be found at: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/00599.html>

### *Sanctions*

Ultimately, the OECD states that the most effective deterrent to collusion among firms is to develop best practices alongside strong enforcement (OECD 2010, 30). High penalties – civil, criminal and administrative – have proven to be the most suitable means to fight both bribery and collusion (OECD 2010, 30).

It is important that the national law or anti-trust law defines in detail which exchanges are prohibited so that companies are able to self-assess the legality of their actions. Heavy sanctions mean that future firms will have an example to adhere to, as well as the recovery of public funds that have been lost through bid rigging.

The OECD also recommends that in the invitation to tender, a warning regarding the sanctions in the particular jurisdiction for bid rigging may be included, such as the fines and prison terms under the competition law (OECD 2010, 3). This warns participating parties of the consequences of collusion before the bidding process has begun. The OECD provides the example of the United Kingdom’s heavy fines for anti-competitive or corrupt behaviour as being effective deterrents, predominately through the resulting bad publicity and the possibility of no longer holding certain company offices (OECD 2010, 13).

Another method of sanctioning offending firms more strongly is made in a European Commission white paper, which argues that, to deter cartel formation, those who are inadvertently harmed by the collusive behaviour should have the right to sue for damages (World Bank 2011, 19). Collectively, the prospect of



criminal charges, fines, and bad publicity will prevent many from engaging in fraudulent activity.

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