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FIGHTING CORRUPTION AND PROMOTING COMPETITION

Background note

-- Session I --

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FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Background Note *--

1. Introduction

1. This paper examines the interface between corruption and competition. Hence the forms of corruption with which we are concerned involve the decision making powers of public officials and elected representatives that are located at the interface between the public sector and private sector (that is, the business sector), or what may be otherwise characterised as the interface between the state and the market.

2. These interfaces are generally covered, firstly, by public sector procurement which, per definition, involves an interface between the public sector (as purchaser of goods and services) and the private sector (as supplier of goods and services) and which in value terms unquestionably constitutes a significant share of 'grand corruption'.

3. Secondly, public sector/private sector interfaces cover that wide range of activities in which public sector officials exercise, with varying degrees of discretion, decision-making powers which have critical business implications. These may include a variety of licensing powers, the imposition of an import tariff or an electricity tariff, the creation and allocation of a public funded subsidy and a host of other critical factors that impact directly on business decisions and performance. In this relationship the public sector supplies one or other of a variety of rights of access – it may be to a market or to a public infrastructure or to a subsidy –to the private sector, the purchaser or recipient of the right or subsidy in question. The decision making power to which we refer extends from the design and development of the programme in question to the administration of the programme which may include the power (with varying degrees of discretion) of civil servants to identify the firm or firms who are recipients of the rights supplied. It is precisely this decision-making power that formed the basis for much of the early literature on rent-seeking. The concepts of 'rent' and 'rent seeking' are central to a discussion of competition and corruption and will be elaborated below.

4. While this paper covers a great deal of what is widely understood to constitute corruption, it does not cover all forms of corruption. For example it does not cover corruption that occurs all-too-frequently in the interaction between public servants and individual members of the public, conduct that is typically and often misleadingly referred to as 'petty' corruption.

5. Nor does the paper cover corrupt conduct perpetrated by public servants acting alone, without an interface, i.e. actions that do not involve other government institutions, the corporate sector or members of the public. A characteristic instance is where a public servant uses public resources for private purposes, ranging from the official who uses her department's car for conducting her private business on weekends, to the holder of high political office who has his private residence refurbished at public expense.

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6. Finally, the paper does not address a pertinent topic but one which could be fruitfully canvassed in this roundtable and in the submissions of the participants. This concerns the question of corruption within the ranks of competition authorities themselves.

7. In competition law enforcement, a sphere in which the line between legitimate and illegitimate rents is blurred and case-specific, and in which there is a particularly close interaction between public power and private conduct, the opportunities and incentives for corrupting this interaction are self-evident. And yet while the possibility of political corruption is much discussed, generally in the form of debates about the necessary degree of independence of competition enforcement decision-makers from political influence, there is little discussion of the nature of the relationship between the competition authorities and their private counterparts. While outright corrupt conduct by competition officials has occasionally reared its head publicly, a superficial impression suggests that this is relatively rare. Certainly competition authorities which deal with a diverse range of firms and sectors are less easily subject to ‘capture’ – often a euphemism for corruption – by the firms that they regulate than are sector regulators who generally regulate the conduct of a small number of powerful, frequently state owned, firms.

8. However, what is clearly of potential interest from this perspective is the ‘revolving door’ - the movement of individuals between positions of public office and jobs in the private sector - which characterises the working lives of competition practitioners in many countries. It would be interesting to learn from the agencies represented at this roundtable, how they ensure, and how they are seen to ensure, that the boundaries between the competition regulator and private-sector firms are untainted by interest conflicts and even outright corruption, particularly given the ‘revolving door’ phenomenon.

9. The following section will examine the concept of economic rent and its relationship to competition and corruption. Section 3 will examine the relatively sparse literature in the economics profession that examines the relationship between competition and corruption. Section 4 will categorise various types of corruption. Section 5 will examine the anti-corruption and pro-competition enforcement challenges and opportunities presented by the interfaces between corruption and competition. This includes key questions such as whether there is a role for competition authorities in addressing key regulations that may create scope for rent seeking; whether there are competition-friendly approaches to industrial policy that generate ‘good’ rents and that minimise rent-seeking opportunities; whether horizontal cartel conduct such as bid rigging can be tackled more effectively by addressing corrupt vertical relationships and whether anti-corruption enforcement is more suited to addressing certain competition problems than the competition regime. Section 6 concludes.

2. Economic Rent – for good and for bad

10. The concepts of ‘economic rent’ and ‘rent seeking’ are central to the interface between corruption and competition. The standard neo-classical definition of ‘economic rent’ is that portion of income paid to a factor of production in excess of that which is needed to keep it employed in its current use. However, for present purposes the Ricardian definition of rent as the return generated by an element of fixity of supply in a factor of production, though broadly similar to the standard neo-classical definition, is more on point. The Ricardian definition immediately focuses attention on the relationship between rents and competition insofar as it clearly reveals that the source of rent will be eliminated by expanding the supply of the factor in question. Hence in Ricardo’s own much-cited discussion of rent, the rent earned by the corn landlords would fall away if England opened up to imports of corn or brought marginal land into production. In short: rent would be driven down by competition.

11. 'Rent seeking' is commonly defined as an attempt to obtain economic rent by manipulating the environment in which economic activity occurs, rather than by creating new wealth.¹ A more extensive definition is provided by Khan (2000):

'Rent-seeking is the expenditure of resources and effort in creating, maintaining or transferring rents. These expenditures can be legal, as with most forms of lobbying, queuing, or contributions to political parties. But they can also be illegal, as in the case of bribes, illegal political contributions, expenditures on private mafias, and so on. The processes are of tremendous significance because the resources they use up are a social cost, and they determine the types of rents which are created and maintained in a particular society'.

12. In the discussion that follows we maintain, for illustrative purposes, a clearer, albeit somewhat artificial, separation between rent generation or rent creation, on the one hand and, on the other, rent-appropriation, although we recognise that in reality they are often, if not always, closely linked and both are the target of rent-seeking activity.

13. In the lexicon of economists 'rent' and 'rent seeking' are generally used pejoratively, as a by-word for unproductive expenditure, often, although by no means always, involving unlawful corrupt conduct. However the role of economic rent in the performance of firms and economies is, in reality, a complex one. Indeed the opportunity to generate economic rent is at the heart of the firm-driven competitive process, just as it is at the heart of key government initiatives aimed at improving economic performance.

14. Economic rent is generated by the self-interested decisions and actions of entrepreneurs and firms, both by their anti-competitive and their pro-competitive conduct. Indeed it is precisely the promise of earning a temporary monopoly rent that spurs innovation, be that in the form of a new blockbuster product, an improved work process, a new approach to marketing or a superior logistics chain. The rent-seeking costs entailed in the generation of these 'good' rents are those incurred in the costly and risky process of research and development, most clearly evident in the case of new product development.

15. But it is also the promise of rent that incentivises a firm to collude with its competitors or to take action designed to exclude rivals or would-be rivals from its market. The role of competition law is to ensure that these lucrative monopoly rents – rents effectively derived from market imperfections - are created and maintained by pro-competitive conduct. Or, expressed in the language of enforcement, competition law enforcement is intended to ensure that rent is *not* secured by means of anti-competitive mergers or collusion, and that the rents are *not* maintained by exclusionary conduct, including abuse of the patent process.²

16. However firms are not islands and hence rents are not only, or even predominantly, derived from the pro- or anti-competitive conduct of firms acting on their own. Complementary state action is often necessary in order to secure rents for selected firms and sectors. Monopoly rents created by public conduct are generally not within the jurisdiction of competition law enforcers, but they are, and should be, the target of their advocacy activities.³

¹ <http://thelawdictionary.org/rent-seeking/>

² Patents rate a special mention because they represent a clear instance of state action in support of monopoly rents in order to incentivise pro-competitive innovation.

³ The jurisdiction of the European Union's competition directorate over national state aid being the outstanding exception, an exception the origins of which are to be found in the single market imperative but which, in the process, extend to the competition enforcers a jurisdictional sweep over industrial policy not found elsewhere.

17. Patent protection of intellectual property rights aside, the rents created or maintained by state intervention have not been well received by economists. The early literature on rent-seeking proceeded from the standpoint that the most common and costly basis of monopoly rent is state action driven by the decisions and the conduct of self-interested public officials, decisions that are driven by the share of the rent which the public servant could appropriate. All regulation, including regulation that is positive and necessary, generates rent-seeking opportunities. This is most easily illustrated by regulations which control access to a market.

18. The rents which derive from controlling access to a market typify the rent-seeking upon which the early economics literature focused. As we will elaborate, these interventions do not necessarily generate new rents. They are predicated on the existence of rent in all markets that are not perfectly competitive. Or, prosaically expressed, they are predicated on the knowledge that there is fat, in the form of supra-competitive profit, in imperfectly competitive markets, and it is this fat that is the target of the rent seeker.

19. However, the issue of economic rent generated by public conduct has become more complicated and nuanced, particularly in discussions of economic development. Many economists, and particularly those who have attempted to understand the stand-out successes of the Asian tigers, have given publicly generated rent a notably more positive cast, characteristically manifest as support for industrial policies.

20. Industrial policies and support programmes purposefully set out to secure rents. That is to say the provision of public support is manifestly designed to incentivise private investment in selected firms, sectors or capabilities. This support may take any of a multitude of forms. However, the programmes generated by industrial policy are generally rooted in the effective creation of monopoly rights, or, at least, in some form of protection from competition or the granting, via a politically organised transfer, of a privileged position in the competitive process, to selected firms or sectors. Protection from international competition, export incentives, the subsidisation of R&D costs or workforce training costs, the provision of concessionary finance, the extension of an exclusive license to operate in a prescribed area or an exemption from a country's competition law and the provision of a targeted piece of infrastructure – for example, the construction of a rail link between an inland mine and a port - are common and varied forms of industrial policy.

21. The support extended to the selected firms or sectors is justified by the potential for the investment thereby incentivised to generate 'good' rents, rents that create positive outcomes for the society and economy – for example new competitive technologies, the development and diffusion of necessary skills and workplace experience, the graduation of a sector from dependent infant to international competitiveness, export earnings. But each embodies the potential for the private appropriation of the resulting rents, for rent-seeking, with the public servants responsible for creating these programmes and selecting the beneficiary firms well-positioned to seek a share of that rent.

22. In summary then the generation of economic rent and the potential for rent-seeking, whether arising from public regulation or industrial policy interventions, occurs at the interface between the public and the private spheres. This is particularly evident in the exercise of regulatory authority and in the development and administration of industrial policy programmes. It is less true of the rents generated by firm-level innovation although, as will be elaborated below, patent abuse may generate rents in excess of those required to reward and incentivise pro-competitive innovation.

23. The public/private interface and its relationship with corruption are elegantly expressed by one scholar:

In well-balanced systems there are realms where official power may not intrude, and things that may not be bought and sold. Institutions on both sides must have some degree of autonomy: both public officials need to carry out their work in an uncompromised, authoritative way, while

*private property and contracts must be respected. Where such boundaries exist, free interaction within each realm is more secure: it will be more difficult for economic interests to turn politics into an auction, and for officials to plunder the economy. But legitimate paths of access between the two arenas are still needed: policies must reflect economic realities, and self-interested behaviour must be subject to the rule of law. If connections between the political and economic arenas do not legitimately exist, they will be created corruptly.*⁴

24. The glib solution to the problem of ‘illegitimate’ connections between ‘official power’ and the market is to limit the extent of public-policy based interventions in the economy, thus limiting the prospect of illegitimate public/private interfaces. However, while public policy, and particularly competition policy, should continue to adopt a sceptical approach to policy based market interventions, an approach which would support deregulation and privatisation, there are distinct limits to the extent to which the state can remove itself from the market.

2.1 The state and the market

25. The arguments for continued public intervention in markets fall into two broad and related categories. These are, firstly, a range of social and economic factors that favour public intervention in markets. Secondly, there are a range of industrial policy arguments in favour of intervention.

26. Both sets of arguments are frequently underpinned by strong populist appeals. Hence while ill-defined notions of ‘healthy’ or ‘fair’ competition may enjoy public support, equally vague notions of allegedly harmful ‘cutthroat’ or ‘unfair’ competition achieve popular currency. And so, for example, small firms, those firms who are often perceived to be the victims of ‘cutthroat’ competition, are generally seen to require protection from their larger counterparts, despite the very real possibility that they are small because they are inefficient. Or it is generally easy for populist politicians to persuade the citizens of most countries that local firms should be protected by trade restrictions or public procurement preferences from competition with foreign firms, notwithstanding international trade and investment rules to the contrary. The list of those national objectives and interest groups that are invoked to justify suspending or ‘managing’ competition is endless – employment, food security, depressed regions, national security; all of these and many more, are commonly invoked as justifications for supporting selected firms and sectors rather than accepting competitive outcomes.

27. However many of the arguments that justify market suppression have deep social roots, even if not all are universally accepted. Hence no sane person responds to the problem of human trafficking by proposing the legalisation of an international market in human beings. And while there is a respectable body of opinion that supports a legal market in marijuana, few propose the same prescription for heroin. Invoking some or other set of national cultural or religious norms many countries prohibit the production and sale of alcoholic beverages while permitting an unregulated market in tobacco products. Others regulate the sale and marketing of both of these products and still others regulate neither. Some countries permit, in the name of the constitutional rights of their citizens, the relatively unregulated sale of semi-automatic weapons, while others impose strict regulations on the sale of any weapons. How does one explain, if not by reference to ‘cultural’ factors, the starkly divergent approaches of two highly developed regions like the European Union and the United States to genetically modified foodstuffs? As we will elaborate, notions of what constitutes corruption are also heavily influenced by social and cultural norms and national circumstances (see Box 1).

⁴ Johnston (2000).

Box 1. Perceptions of corruption

Different societies have different perceptions of corruption. Where an action is perceived to be corrupt in one society, it may be normal practice and acceptable in another. In Indian societies, corruption “*has, with the passage of time, become a convention, a tradition, a psychological need and necessity so to say.*” (Kohli, 1975, p.32, as cited in Treisman, 1998). In Southern Italy, where it was commonplace to support the interests of the nuclear family, dubbed by Banfield (1958) as ‘*amoral familism*’ where ‘*a social equilibrium in which people exclusively care about their immediate family, exploit those outside the family, and expect everybody else to behave in that way*’. Corruption in the form of gross nepotism and all that derived from this particular corrupt practice is seen as acceptable. “*Corruption in Latin America is not merely a social deviation, it is a way of life*” (Diament, quoted in Little and Posada-Carbó, 1996, p.10, cited in Treisman, 1998). In Mozambique, “*paternalism and patronage networks still play an important role....As a result, behaviours which are usually considered conflicts of interest, nepotism, and favouritism are not generally viewed as corrupt practices in the country. Instead, Mozambicans who achieve ‘important’ positions are commonly expected to use their position to help family members and friends*” (USAID, 2005, cited in Martini, 2012).

Melgar, Rossi and Smith (2010) find that better economic performance of a country tends to reduce the perception of corruption by residents in that country, while macroeconomic instability and income-inequality have the opposite effect. Ranking perceptions of corruption in different countries, they find that in Latin American, Asian and former socialist countries, residents tend to perceive higher corruption levels than residents from other countries when asked how widespread, in their experience, corruption was in the public service in their country. In general, residents in European countries, Canada and the US perceived lower levels of corruption in their respective countries (with the exception of Portugal).⁵

What types of conduct are perceived as corruption in different countries is therefore highly subjective, influenced by the history and culture of the country. Often, lobbying which is legal and which may be more common in developed countries is not viewed in as negative a light as an outright and illegal payment of a bribe to a public official, although the outcomes and the reliance of mutual personal material gain to drive those outcomes may be similar. Where the line is drawn between legal, even socially productive, lobbying and illegal influence peddling can be unclear. So while the perception in European countries, or in the US, may be that corruption is lower than the perception in developing countries, it is important to understand what constitutes corruption in these perceptions. This is vividly expressed in the view – still widely held if not quite as prevalent as it used to be – that the payment of ‘*facilitation fees*’ or even outright bribes is the socially accepted mode of doing business in developing countries and so should not be construed as corruption. And so, major developing country multinationals adopted a different standard for construing corruption in, on the one hand, their home markets, and, on the other, in developing country markets. As, of course, did their governments, several of which famously permitted the expensing of bribes in developing countries, conduct for which they may have faced prison time had it been perpetrated in their home markets.⁶

The terms used to describe corruption and bribery in particular are also culturally and nationally derived, although all are invariably euphemistic. And so a traffic policeman in North Africa may ask a motorist for a cup of ‘*kahwe*’ or coffee, while in South Africa you would be asked for a ‘*cooldrink*’, in Kenya for ‘*chai ya wazee*’ or ‘*tea for the elders*’ and in Turkey for ‘*chorba parasi*’ or ‘*cash for soup*’. In Hungary doctors and nurses will refer to the envelope of money received from their patients as a ‘*haalapenz*’ or ‘*gratuity*’ while in China healthcare workers and government officials expect ‘*yidian xinyi*’ or ‘*little token of gratitude*’, while in Russia, the expression ‘*spasibo v karman ne polozhish*’ or ‘*you cannot put ‘thank you’ in your pocket*’ commonly precedes a discussion that culminates in the payment of a bribe. In languages and cultures as diverse as English, Farsi, French and Swedish a popular term for corrupt payments translates into English as ‘*money passed under the table*’.⁷

⁵ Melgar, Rossi and Smith (2010).

⁶ Certain countries, such as Germany, have specific rules and regulations overseeing the activities of lobbyists and interest groups. Lobbyists are required to register with the German Bundestag and the register is made available to the public annually. Given the difficulty in defining what constitutes a lobbyist, other countries such as the UK regulate the lobbied rather than the lobbyists. <http://www.enviro.ni/en/Publications/LocalGovernment/Administration/FileDownload.2048.en.pdf>

⁷ <http://www.bbc.co.uk/news/magazine-23227391>

28. In addition to the regulatory interventions outlined above there are also a myriad of regulations that are necessitated by factors that range from the state's duty to protect public health and safety to environmental considerations to the gathering of data necessary to support an effective taxation regime. But as will be discussed below, although many of the public regulations ostensibly designed to achieve some or other public good, serve little more than the rent-seeking aspirations of public servants, there remain significant limits to the extent to which even the most liberal state can eschew the requirement for wide ranging regulation.

29. Economic regulation responds to actual or perceived market failures, including, but not limited to, instances where scale economies or network economies which lend themselves to anticompetitive conduct severely curtails access to markets. Economic regulation in relation to infrastructure services refers to the "*combination of institutions, laws, and processes that, taken together, enable a government to exercise formal and informal control over the operating and investment decisions of enterprises that supply infrastructure services*" (Brown, Stern, Tanenbaum & Gencer, 2006, p.5). Economic regulation, through competition regulation for instance, extends beyond just infrastructure services regulation (Steyn, 2012). A good regulatory framework allows for lower network service costs, better quality service, increased investments in expanding networks and efficient network platforms that support competitive outcomes (Joskow, 2008). However economic regulation is also vulnerable to corruption and regulatory capture.

30. Privatisation (discussed further in Section 5), is in turn, a potential response to the failings of state ownership and regulation however the process of privatisation is itself notoriously vulnerable to corruption (Megginson and Netter, 2000).⁸

31. We have already referred to the case made for industrial policy based interventions, that is, interventions designed to bolster the pace and direction of economic growth. Again while competition law enforcers and competition policy makers would do well to maintain a healthy scepticism towards industrial policies, in reality they are widely practiced in developed and developing economies, partly because they enjoy the support of powerful interest groups and leading economists, but also because selected industrial policy programmes have, on occasion proved effective in influencing the pace and trajectory of economic growth and development. We will return to this below. At this stage we merely note that successful industrial policies appear to be those that work with, rather than against, the market and those that limit the capacity for rent-seeking.

32. The point of this paper is not to debate the merits of these various public policy based market interventions. It is to underline that each of these interventions – including those that produce little-disputed social returns – potentially generate significant rents and concomitant opportunities for rent seeking, with its associated costs, costs which generate no new wealth. This reality bears out the arguments of the early rent-seeking literature that competitive markets will limit excessive rents and rent-seeking; and conversely that administrative intervention in markets will generate rent-seeking opportunities. However this fundamentalist view and the logic of its policy conclusions cannot stand up against regulation that is necessary and desirable; nor can it prevail in the face of regulations deeply rooted in cultural norms.

33. And the public advocacy task that would seek to limit industrial policy-based interventions to 'guide' markets will confront powerful interest groups and the imperative that the state be seen to be 'doing something' in the face of low growth and widespread poverty and inequality.

⁸ Megginson and Netter (2000) give the example of Russia's 'disastrous' 1995 Loan-for-Shares privatisation programme, which transferred control of the valuable natural resource firms to a small group of "oligarchs" at very low prices. The authors, citing Black et al (2000), explain that this resulted in widespread insider expropriation which was part of the problems that led to the decapitalisation of much of Russian industry. See Box 11 for further examples.

34. In short, there is considerable official and popular tolerance for programmes that override competitive market outcomes. The degree of tolerance will be determined by the relative strength and weakness of the competition culture, by the distribution of the rents generated by the market interventions in question, by the ability to limit rent-seeking activity and by government's track record in introducing and managing rent-generating and competition-overriding programmes.

2.2 *Summary*

35. Our point then is three-fold:

1. Support for competition, just as for market-guiding (or, as many economists would have it, market-distorting) interventions are, in part, socially constructed, with a concomitantly significant element of national specificity. Equally there are no globally fixed notions of what constitutes corruption, nor is there agreement over the extent of rent-seeking that a country is prepared to tolerate for the benefits that may accrue from a rent-generating public programme.
2. It is at the interface between, on the one hand, the private agent and, on the other, the public agency responsible for administering public regulations and industrial policy programmes that rent is generated and that rent-seeking costs are incurred and that the *potential* for corruption exists. Hence, the commonly cited definition of corruption as '*the abuse of public power and public resources for private gain.*'⁹
3. Following on from the preceding points, anti-corruption strategies that rely on promoting competitive markets in order to limit the generation of rents, will have to take account of national specificities and 'public interest' or, usually, interest groups factors, as well as market failures, that will impose limits on competitive markets. There is little point in attempting to persuade a country that, for deep-seated cultural reasons, suppresses the market in alcoholic beverages or genetically modified foodstuffs that the rents and the associated rent-seeking costs are generated by the market repression and would be limited by creating a transparent market in these products. Equally, there is little point in discouraging support for university science in order to limit the associated rent seeking, if the result of this advice is to dry up the supply of scientists and the returns, both social returns and privately appropriated rents and rent-seeking costs, associated with the research subsidies. In short, removing the state from the market may be the first-best approach to combatting corruption and in many instances may be feasible. But, inevitably the complex and important challenge is to devise and implement second-best approaches that ensure that rents do indeed generate positive outcomes and that limit rent-seeking costs.

36. The following section will survey the literature that persuasively demonstrates a robust correlation between, on the one hand, low levels of competition and, on the other, high levels of corruption. We will argue that the causal link between competition and corruption runs both ways, that is to say, that low levels of competition beget high levels of corruption and that high levels of corruption undermine competition.

⁹ A fuller definition of corruption and one that somewhat mitigates the normative content of definitions of corruption is '*behaviour that deviates from the formal rules of conduct governing the actions of someone in a position of public authority because of private-regarding motives such as wealth, power or status.*' (Khan, 1995, p. 3)

3. Correlating Competition and Corruption

37. Economists have attempted to explore correlations between competition and corruption.¹⁰ The research, bedevilled by the necessity to use proxies as measures of both phenomena, generally finds an inverse relationship between the two. That is to say, low levels of competition correlate with high levels of corruption. The explanations proffered for this relationship suggest that because low levels of competition lead to higher rents, the potential returns from, and hence the incentive to engage in, corruption are increased.

38. The correlation between low levels of competition and high levels of corruption is confirmed using a range of measures of each variable. Hence Ades and Di Tella (1999) find that competition, measured using indices such as competition from foreign firms, is inversely related to corruption. They also find that other measures, like the distance to trade and measures of rents, such as the proportion of total exports accounted for by fuels, minerals and metals which provides a measure of exogenously created rents for domestic firms, are positively related to levels of corruption. In addition, a step increase in rents (as a result, for example, of the discovery of a natural resource) is found to lead to increases in corruption.¹¹ In general, higher corruption levels are found where there are fewer firms, where there are higher rents to be made by the domestic firms, where firms are more sheltered from foreign competition and where countries have ineffective competition regimes.

39. Ades and Di Tella (1994 and 1997) also looked at openness to trade as an indicator of competition. Using corruption data in a sample of countries, they find that the ratio of imports to Gross Domestic Product (GDP) was negatively correlated to corruption - the higher the ratio of imports to GDP, the lower the levels of corruption. Brunetti and Weder (1998c) find similar results using a cross-section of 122 countries. It has been argued however that the use of imports to GDP ratio is a flawed indicator of levels of competition. Others have therefore measured the extent of competition by the number of years a country has been open to trade (Sachs and Warner, 1995; Treisman, 1999a and Leite and Weidmann, 1999) and have found similar correlations.¹²

40. A range of somewhat less reliable indices such as the extent of market dominance (essentially through assessing market concentration and barriers to entry) and the effectiveness of anti-trust laws in a country have also been used to assess the impact on corruption, with the results showing that when using these indices of competition, the correlation is confirmed: economies that are less open to competition evidence higher levels of corruption (Ades and Di Tella, 1994).

¹⁰ Early work on the interface between competition and corruption focused on competition between officials receiving the bribes, rather than on competition in the 'bribers' market (Krueger, 1974; Rose-Ackerman, 1978); Shleifer and Vishny, 1993), while more recent work focuses on the causes and economic consequences of corrupt governments (Bliss and Di Tella, 1997; Ades and Di Tella, 1999).

¹¹ Other work by Bliss and Di Tella however was not conclusive on whether an increase in what they termed 'deep competition' led to lower levels of corruption and the result depended on the structure of the uncertainty about costs that the corrupt official faces. They measure deep competition through three measures: as a parameter that affects profits in any firm (such as transport costs); lower overhead costs relative to profits and less dispersed overhead costs, and more similar cost structures between firms (a factor that makes entry easier). Firms with lower costs are able to make higher profits that a corrupt official extort. Increases in competition can result in the most inefficient firms, with higher costs, to be the first to exit. Therefore competition reduces number of firms operating and enhances the profitability of existing firms. But at a certain point, the exit stops as the official is not willing to risk losing his source of their bribe income. The point of exit depends on the cost structure of the firms, something the official may not have perfect information about (Bliss and Di Tella 1997).

¹² As cited in Lambsdorff (1999). See also Svensson (2005)

41. However, the powerful, astute, but corrupt public official will not be content to passively extract an ‘entrance fee’ from firms wanting to participate in a market to which access is limited by the necessity to cross a range of regulatory hurdles. He will be aware that the less competitive the market, the greater the rent generated and the greater the opportunity for rent seeking. Therefore the causality explaining the inverse correlation between rent-seeking and corruption is plausibly theorised to run both ways – that is, both from low levels of competition to high levels of corruption and from high levels of corruption to low levels of competition. That is to say, the public official who actively sets about stifling competition by limiting entry to, or inducing exit from, a market will simultaneously serve the interests of incumbent firms by generating greater rent as well as his own private interest through enhancing the potential for rent seeking and through narrowing the number of targets of his rent-seeking activities, thus lowering the risk of detection.

42. Nor are firms innocent bystanders in this process of rent generation and appropriation. Cognisant of the additional rents to be generated from low levels of competition, firms will not only proactively induce public officials to restrict market access, they will actively lobby in favour of exclusionary legislation and regulation. They will engage in private exclusionary conduct in full knowledge of the cost and limited prospect of success entailed in apprehending and prosecuting this conduct.

43. Indeed exclusionary conduct need not necessarily contravene competition law Lobbying or engaging in costly and time consuming strategic litigation may be sufficient to limit new entry (Roberts and Makhaya, 2012). In regulated markets information asymmetries between powerful incumbents and regulators or, failing that, the operation of an active revolving door utilised by the senior staff of the regulator and the firms they regulate, give rise to regulatory capture, often a euphemism for corruption, but again although these practices may test ethical boundaries they will not necessarily break the law. And even hallowed patent-protected intellectual property rights may be abused by the beneficiary firms. Again while this abuse rarely, if ever, falls foul of anti-corruption statutes, it certainly constitutes the manipulation for private gain of the environment in which economic activity occurs – the standard definition of rent-seeking – and is increasingly attracting the attention of competition enforcers.

44. Hallward-Driemeier (2009) highlights the influence of corruption on firm exits and the resultant impact on aggregate productivity. In more corrupt environments, firms have to be more productive to survive, if not, they will be forced to exit. On the other hand, corruption could enable more inefficient firms to remain in business and in this sense, the relationship between corruption and productivity tends to be negative. Which effect dominates depends on whether corruption is seen as ‘grease money’, which speeds up transactions or as ‘sand in the wheels’, which slows down progress in attaining outcomes. Hallward-Driemeier’s results show that the investment climate, which encompasses variables such as the efficiency of government services, access to finance, the extent of corruption¹³ or cronyism, the strength of property rights, and the degree of competition¹⁴, impacts firm exit rates differently depending on the type of firm.

45. While the inverse relationship between competition and corruption appears fairly robust, there are of course variables other than competition that affect corruption. Using cross-country data Emerson (2006) finds that, in addition to the level of corruption being inversely related to competition, the more

¹³ Corruption in this study was measured as the share of sales paid as a bribe to ‘get things done’; the sale of a government contract that is paid as a bribe, and how frequently firms perceive bribes as being paid ‘to get things done’. Questions were also asked around the size of the bribe and what the firm could do if solicited (Hallward-Driemeier, 2009, p. 19).

¹⁴ Competition was measured through entrepreneurs’ ranking of the extent of import competition, pressure to reduce costs or increase innovation from domestic or foreign sources and a measure of the degree of anticompetitive practices as an obstacle entrepreneurs face in operating and expanding their businesses (Hallward-Driemeier 2009, p.19).

civil liberties there are, including more citizen involvement in governance and greater monitoring of public agents, the lower the levels of corruption. An informed and educated population including a free and active press, the degree of political participation in the country and the presence of an independent judiciary all increase the chances of detection and punishment. In other words, factors that influence the likelihood of the public knowing that corruption is occurring and factors that influence their ability to combat it influence the level of corruption (Emerson, 2006). Studies attempting to assess the relationship between democracy and corruption have usually shown inconclusive results (Paldam, 1999a and Treisman, 1999a), but when uninterrupted democracy has been measured (since 1950 for a set of 64 countries), it has been found that a long period of exposure to democracy lowers corruption.¹⁵ As with deterrence of any criminal behaviour or anti-competitive conduct, deterrence of corruption depends on the probability of detection and severity of punishment. But this is not limited to legal consequences, other costs such as reputational loss or shame may also serve as a deterrent (Becker, 1968).

46. Other market characteristics also affect the probability of corruption. Becker discusses how if repeat business is important to a firm's profitability, then corrupt behaviour would discourage customers from returning, particularly if a competitive environment allows for customers to switch easily.¹⁶ This would negatively impact on a firm's profit and therefore the firm, when faced with competition, would be discouraged from engaging in corrupt behaviour. He gives the converse example of tourist centres, where repeat business is, Becker argues, not important. Here the tourist has no incentive to invest in the reputation of the tourism centre because he is unlikely to repeatedly return to the same location and so in that case his experience with corruption is not likely to substantially impact on his subsequent behaviour. Becker also argues that firms in industries with high levels of regulation, even if there is a reasonable degree of competition such as in the banking industry, have increased incentives to engage in corrupt behaviour. Given the extensive and complex regulations governing the banking sector, there are financial gains to be made if banks can induce regulators and other officials to act in their favour. The large quantity of money involved further makes the banking industry more conducive to corruption.

47. In addition to where there were lower levels of competition, a 2001 study that used firm-level data to assess corruption in utilities in Eastern Europe and Central Asia, found bribes paid to utilities to be higher in countries with constraints on utility capacity and where utilities were state-owned. From the bribe payer's perspective, firms with higher levels of profitability, higher overdue payments on utility bills and newly privatised firms were found to pay higher bribes (Clarke and Xu, 2002).

48. While the work surveyed in this section persuasively correlates competition and corruption, and the theorisation of that correlation supports a two-way causality – less competition leads to more corruption, and more corruption leads to lower levels of competition – it suffers from insufficient appreciation of the specificities of types of corruption. While the literature surveyed here tends to take a homogenous view of the nature of corruption itself, the literature on corruption exposes varying types of corruption, with consequent implications for the impact of corruption on economic development and for policy measures to combat it. In short while the findings surveyed in this section do strongly suggest that policy interventions designed to combat corruption and those designed to promote competition should be complementary and should work in tandem, these arguments and the policy conclusions drawn from them, need to be bolstered by a deeper appreciation of how corruption works. The next section unpacks the different forms that corruption takes.

¹⁵ Svensson (2005).

¹⁶ 'Government Regulation, Competition, and Corruption' - <http://www.becker-posner-blog.com/2012/10/government-regulation-competition-and-corruption-becker.html>

4. Categorising corruption

49. Corruption, which, for the purposes of this paper, is conflated with rent-generation and rent-seeking, may be placed in two broad categories. The first category is what may be termed ‘public service corruption’; the second category is ‘political corruption’.¹⁷

50. **Public service corruption** may in turn be placed in two conceptually distinct, but practically overlapping categories. The first encapsulates the abuse of the gate-keeping functions and discretionary decision-making powers of public servants. As already mentioned this is the corruption that attracted the attention of the early work on rent-seeking. Regulations which may serve a perfectly positive and reasonable purpose are abused by those responsible for administering the regulations. The range of ‘gates’ is vast, effectively encompassing all of state/market or public/private interfaces extending from the health inspector who determines whether a restaurant may remain open for business, to the telecommunications regulator with the power to license a new entrant; from the metro police officer who determines whether a small trader is violating a traffic by-law, to the public official who decides whether the requirements governing a tender have been met by a given bidder.

51. The rents appropriated by the public official in the exercise of this gate-keeping function are irredeemably ‘bad’ – they create no additional wealth. We should emphasise that these rents sought and appropriated by public servants do not even presuppose the creation of new rents, much less new wealth. Market imperfections underpin rents and so simply possessing the power to influence market access creates the opportunity to extract a portion of the rent that a firm will earn in an imperfectly competitive market. The scale of the rent available for appropriation by the rent seeking public official will be determined by the extent of the market imperfection which determines the amount of rent which the firm, the target of the public official, may earn.

52. Hence the pickings available to the police officer with gate keeping power over the street trader or that of the health inspector over the restaurant may be relatively small because the markets in question are relatively competitive and the overall level of rent that is available for extraction without driving the rent-seeker’s source of rent out of business may be low in absolute terms, although it may impact massively on the profitability and viability of the enterprises in question. On the other hand, the rents generated by gaining access to a telecommunications license or winning a tender for sophisticated IT equipment may be very large because the markets are far less competitive.

53. However, as already noted, the extent of market competition may itself be the outcome of the decisions of public policy makers and administrators, those who have an interest in appropriating a share of the rents themselves. Restricting the number of pharmacies permitted to operate in a given geographical area or the number of banking or telecommunications licenses may – or may not – make good public policy sense, but it will certainly increase the available rents that accrue to the recipients of a license to operate and that are potentially appropriable by the policy maker and the public official who determines the extent of new entry and the identity of the participants.

54. In summary then, when the public officials are in a position to generate additional total rents – that is, to create greater market imperfections – the negative impact of their conduct increases greatly. Not only will additional monopoly rents be created with no compensating societal benefit, but the potential take of the public official arising from the exercise of this gate-keeping function is greatly enhanced. If by his decision to limit entry or hasten exit he is able to further compromise the competitive structure of the market in question, he will not only have the direct target of his regulatory discretion willing to part with a portion of his rent in order to enter or to expand in the market, he will also have the incumbent willing to

¹⁷ This section adapts the work of Mushtaq Khan (Khan, 1995,1996, 2000 and 2006).

pay a portion of his rent, possibly a larger portion of the rent, to maintain or increase the market imperfections either by blocking a new entrant or by driving a competitor out of the market or by retarding its ability to expand.

55. Khan succinctly characterises this form of corruption:

The obstacles and rents created by public officials seeking bribes can range from unnecessary red tape and paper pushing that takes on iconic proportions in many developing countries, to the creation of monopolies, tariffs, subsidies and other damaging rents that are both directly damaging for the economy, as well as creating rent-seeking opportunities for public officials and others. Excessive regulation and requirements of permissions often have no purpose except to enable bureaucrats to extract bribes from the private sector. This type of corruption also includes 'petty corruption', involving low-level officials extracting small bribes for performing their duties (speed money), or for not harassing the innocent by deliberately misinterpreting very complex and unclear regulations (customs officials or police engaging in petty extortion) (Khan, 2006, p6).

56. As we will elaborate below the interplay here between corruption and competition is evident because the central factor in the generation of the rent and the mechanisms employed in appropriating it – the rent-seeking – is public sector decision making power in relation to market entry and participation.

57. The second form of potential public service corruption is significantly more complex. This refers to instances when government policy purposefully sets out to create rents which may be appropriated by a firm or a selected category of firms in order to encourage investment in the targeted firms, sectors or regions. This rent – which could take a number of forms, for example, a direct subsidy or tax break, concessionary finance, protection from international competition – is extended, at least ostensibly, because of a social benefit that is expected to accrue as a result of the investment. Public policy may wish to direct investment towards export-earning or employment-intensive sectors, or towards activities that generate learning and investment in training and R&D, or in order to encourage investment in a struggling region or to kick-start an export processing zone. That these rents are deliberately generated and 'well-intentioned' does not of course mean that the expected or potential benefits will actually accrue, or that they would not have accrued in the absence of the rent, in which case all that is left is the publicly funded and privately appropriated rent, a transfer from the public to the rent recipient with no concomitant social benefit.

58. Nor does it mean that there are no rent-seeking costs, even in those cases where the expected benefits do actually accrue. The rent-seeking costs may be generated and appropriated through above-board and perfectly legal conduct (such as the cost of consultancy studies and lobbying in order to persuade government or parliament to introduce a programme that makes the rents available), by conduct on the margins of legal and ethical principles (such as private sector funding of study trips by parliamentary committees to inspect similar programmes in other parts of the world, contributions to political parties) or by conduct that is downright criminal (such as bribery).

59. Indeed from a competition perspective, the rent-seeking costs entailed in persuading government to introduce a rent-generating programme – even one that generates net positive social benefits - may be so significant as to be exclusionary. Rent-seeking may require deep pockets, considerable organisation and carefully cultivated connections in government and the legislature. These resources are not available to all firms and sectors. Where extensive rent-seeking costs have to be incurred – even in legal activities - in order to receive public support, the firms with the deepest pockets and the most developed networks, inevitably large incumbent firms, will be favoured, thus entrenching their market positions.

60. Moreover, for many of the same reasons, there is the ever-present danger that a rent-generating programme will be self-perpetuating. Hence the first round of rent creation and rent-seeking activities may

generate the positive social benefits intended, but it will also generate the funds and the social capital - the networks and the cluster of interests capable of defending and renewing the rents - that support a second round of rent creation and further opportunities for rent-seeking even if there are no further social benefits to be gained from the extension of the programme. In short: even the best intentioned policy maker will find it far easier to introduce an industrial support programme than to withdraw it even once it has achieved its objectives.

61. Whereas the gate-keeping rents and the associated rent-seeking costs referred to earlier are best dealt with by eliminating the regulations (the ‘gates’) and with them the rent-seeking of those who manage the gates or, at least, by limiting the amount of discretion involved in the decision making, the measures designed to deal with the rent-seeking opportunities implicit in the industrial policy programs that generated potentially ‘good’ rents are predictably more complex. They will be elaborated below. Suffice for now to note that the challenge is, firstly, to ensure that the rents generate the intended positive outcomes whether strengthening an infant industry or investing in R&D and training or generating exports or whatever the objective of introducing the rent-generating process was in the first place. Secondly, policy should be directed at limiting or regulating the rent-seeking costs, both those incurred through legal activities and those incurred in unlawful activities.

62. This leads into a discussion of the second broad category of corruption, namely ‘political corruption’.

63. While both categories of public service corruption are driven by the ability of the state to intervene in the economy to create rent and rent-seeking opportunities, the driver of **political corruption** is, benignly expressed, the requirement to achieve political stability. More accurately – although this may indeed be a condition for political stability – it is driven by the efforts of a ruling elite to consolidate and extend its political power.

64. For a variety of reasons the phenomenon of widespread political corruption is more commonly observed in developing countries than in developed countries. The major reason that Mushtaq Khan (2006) – on whose work we have drawn in developing this typology – proffers in support of his contention that developing countries are particularly susceptible to political corruption is to be found in the critical role played by redistribution in creating and maintaining political stability. With their relatively low income and limited tax base, developing countries elites cannot use the fiscus to effect the extent of redistribution required for political stability, which is usually conflated with the incumbent elites’ continued rule. They therefore turn to off-budget mechanisms in order to maintain the coalitions and satisfy the various interest groups whose support they require.

65. The mechanisms of off-budget transfers may range from the targeted awarding of state licences and rights – for example, mineral rights - through to carefully selected access to major state procurement through to politically driven access to concessionary finance. These privileges are directed at the leaders of important political constituencies and factions, and so may be viewed as the price of political stability. Another mechanism of supplying these sorts of patronage payments is by turning a blind eye to the corrupt activities of the leadership of key political centres, such as city and provincial governments. In short, corruption becomes the modality for the redistribution necessary to promote stability. Where stability is achieved a necessary – if insufficient – condition for growth is satisfied which, if achieved, may ultimately generate the income and tax receipts that will enable the stability-enhancing redistribution to take place through transparent budgetary resources.

66. In similar vein, Kaufmann and Vicente (2005, p6) describe high-level political corruption or ‘influence’, which is broader than just bribery, as a “*particular sharing pattern of the joint payoff from the referred relationship*”. They use the example of a well-connected political person who exploits his

connection with the private sector for mutual gain. The relationship is mutually beneficial through a series of repeated interactions over time - the politician assists the private party through favourable legislation or awarding of procurement contracts, while the private party utilises a portion of the rent generated by his privileged relationship with the politician to fund the re-election campaign of his patron *and* his client.

67. Similarly, North, Wallis, Webb and Weingast (2012) contrast limited access order (LAO) societies to open access order societies (OAO). The LAO creates limits on access to valuable political and economic functions as a way to generate rents. LAOs are epitomised by state-controlled industries, problematic business licensing regimes for new entrants, and corrupt patron-client networks. In LAOs, economic actors seek to use the political process to restrict entry and maintain their rents. Political actors, on the other hand, seek to use the political process to restrict entry, create rents, and bind economic actors to support a developing political coalition. The elite create barriers through corruption as it benefits them to limit competition (North *et al*, 2012).¹⁸

68. Achieving sustained levels of growth will also permit the regulation of political corruption. The activities of lobbyists can, to some extent, be made subject to a set of rules and standards which limit the capacity for illicit influence peddling. So-called “pork barrelling politics”, effectively budgetary allocations to consolidate political power, are rendered transparent and are potentially subject to being disciplined through the political and electoral process. Moreover, the economic costs of these legal forms of influence peddling and political pay-offs are also rendered transparent and may potentially be punished through the political process.

69. The tolerance or, at least, the condonation, of political corruption effectively suggested by the above argument is akin to the argument that holds that democracy, including the limiting of corruption, is incompatible with the requirements to make the transition from underdevelopment to development. This is, of course, the elephant in the room in discussions of South Korea’s growth strategy and, now, of China’s growth path. The signal successes of these two experiences of economic development occurred in the context of strong, authoritarian states and were, and in the Chinese case, still are, accompanied by extremely high levels of political corruption.¹⁹ Indeed the extension of democracy and the concomitant limitation of corruption that accompanied South Korea’s transition from underdevelopment to development are invoked as evidence for the argument that economic growth is a necessary precursor to a democratic, relatively corruption-free society. Or expressed otherwise, that democracy and the limitation of political corruption is a luxury that only developed economies can afford.

70. We are not going to engage further with this argument, save to emphasise that while political corruption *may* generate the political stability that is certainly a necessary condition for growth and development, it may be deeply incompatible with other necessary conditions for diversified growth and development, such as certainty and the enforceability of contracts.

71. Nor is political corruption, once it has been allowed to take hold, easy to curb. For example, it is difficult to imagine what possible incentive would exist for a small ruling elite in a high growth/high corruption extractive economy like Angola to turn off the corruption tap. It is far easier to envisage those elites securing ‘stability’ by deploying a portion of their oil sector’s vast revenue flows for the purposes of strengthening the security and military apparatuses, than it is to envisage them taking the revenue flows ‘on-budget’ and then securing stability through transparent fiscal transfers.

¹⁸ See also Meisel and Ould Aoudia (2008).

¹⁹ For China see Transparency International *Transparency in Corporate Reporting: Assessing Emerging Market Multinationals* (2013). For Korea see Khan (2006).

72. Given the paucity of South Korea's natural resource endowment, its elites may have had little option but to turn to democracy and opposition to corruption in order to consolidate and extend the diversified industrial development which characterised that country's economic growth path. However, given the centrality of the extractive industries in the growth prospects and performance of most developing economies, it is difficult to envisage this path of growth undermining political corruption, thus enabling diversified industrial development. This underlines the importance of initiatives like the Extractive Industries Transparency Initiative (EITI) which promotes transparency in extractive industry revenue flows as a mechanism for simultaneously tackling corruption, identifying redistribution opportunities and promoting economic diversification. And it also underlines the importance of international treaties and conventions and the extra-territorial enforcement of developed country anti-corruption laws. By focusing requirements for transparency and anti-corruption enforcement attention on developed country multinationals, the risk of 'supplying' the resources that account for much political corruption has been substantially increased.

**Box 2. The Extractive Industries Transparency Initiative (EITI),
International Conventions and Extra-Territorial Laws**

The EITI is a "global coalition of governments, companies and civil society working together to improve openness and accountable management of revenues from natural resources". Given the potential corruption opportunities associated with poor management of resources such as oil, gas, metals and minerals, countries that have signed up to the EITI Standard are required to ensure full disclosure of taxes and other payments made to governments by oil, gas and mining companies. 25 countries are compliant with the EITI standard (meeting all requirements in the standard); 16 are candidate countries (implementing EITI, but not yet meeting all requirements) and 35 countries have produced EITI reports accounting for USD1,056 billion in total government revenue.²⁰

Aside from assisting in the detection of corruption, some of the benefits of the EITI include increased transparency which improves the investment climate and mitigates certain political and reputational risks; strengthened accountability; contribution to good governance and better accounting of the contribution investments are making to a country or to parts of a country. The above listed benefits are important both for investors, particularly given the capital intensity and long-term nature of extractive industry investments²¹, for governments who can use this information to better guide policy making and for citizens who are better to hold their governments accountable.

There is a range of international treaties and conventions that aim to tackle corruption, the main ones which evolved from, or were modelled on, the US Foreign Corrupt Practices Act (FCPA) of 1977. The FCPA made it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. It made it illegal to use any means to offer payment, or promise payment, or authorise the payment of money or anything of value to any person, when it is known that such payment will, amongst other things, directly or indirectly influence the official to assist in obtaining or retaining business.²² For present purposes it's important to note that the impetus for the Act stemmed precisely from competition related concerns. Corrupt firms secured business through bribery, and not through competition on the merits. Ethical or risk-averse businesses that refrained from corrupt activities were put under pressure to lower their ethical standards or risk losing business opportunities. An increasing number of complaints from influential US business leaders at the time persuaded the extension of anti-bribery norms to their competitors.²³

²⁰ <http://eiti.org/eiti>

²¹ <http://eiti.org/eiti/benefits>

²² <http://www.justice.gov/criminal/fraud/fcpa/>

²³ Spahn (2013).

Amendments to the FCPA in 1988 and concerns in the US that its national firms and other firms subject to US law would be placed at a competitive disadvantage by competitors willing to pay bribes encouraged the US government to support an OECD-based initiative to formulate an Anti-Bribery Convention binding all OECD member states.²⁴ The OECD Anti-bribery Convention establishes legally binding standards aimed at criminalising the bribing of public officials in international business transactions. The OECD Working Group on Bribery carries out monitoring functions of the signatory countries.²⁵ Both the FCPA and the OECD Convention ban paying of bribes, but not the receipt of bribes. All 34 OECD member countries and six non-member countries - Argentina, Brazil, Bulgaria, Colombia, Russia, and South Africa - have adopted this convention.²⁶

A convention which addressed the demand side of bribery was the United Nations Convention Against Corruption (UNCAC). The UNCAC signed in 2005, amongst other objectives, aims to take steps to prevent and criminalise corruption; increase co-operation between countries to fight corruption; criminalise and improve law enforcement measures; assist in asset recovery; provide technical assistance and allow for information exchange. It also requires, amongst other things, state support in enabling the participation of individuals and groups, including civil society and communities in the prevention and fight against corruption.²⁷ Similar to the UNCAC, the African Union Convention Against Corruption which came into force in 2005 aims to establish, maintain and strengthen independent, national anti-corruption authorities or agencies.²⁸

The UK Bribery Act passed in 2010 and which came into force on 1 July 2011 has wider application than the FCPA.²⁹ Unlike the FCPA which is limited to foreign officials, bribes paid to any person to induce them to act “improperly” is prohibited. Also, like the UNCAC, both the briber and the bribed individual are liable under the Act.

73. Middle income developing economies – such as South Africa and a number of large Asian and Latin American developing economies – may be well positioned to combat political corruption because they have already developed significant manufacturing and service sectors, and, with that, powerful interest groups who rely on the continued functioning of those sectors which place a high premium on certain, transparent and enforceable rules. Hence, while in a small number of highly context-specific instances – of which South Korea may be one of the few role models – the prospect may exist of the stability wrought by political corruption easing the path towards economic development, there would appear to be a significantly greater prospect of an Angola or Equatorial Guinea, both extractive economies riddled by political corruption, descending into, brutal failed states, than ascending, South Korean style, into thriving industrial economies.

74. The connection between political corruption and competition is, as with the connection between public service corruption and competition, self-evident. Major public contracts are awarded, not on the merits, but in order to secure the political support of the beneficiaries and the constituencies that they represent; investment decisions – particularly foreign investment decisions – are mediated by politically connected middlemen who perform no function other than securing the necessary political and administrative permissions required for the investment to go ahead, a pure rent-seeking cost. However the costs of political corruption are significantly greater than the dampening impact on competition. It significantly compromises public life and administration.

²⁴ Spahn (2013).

²⁵ Corruption Watch: Corruption and the Law in South Africa, A Quick Reference Guide.

²⁶ <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>

²⁷ Corruption Watch: Corruption and the Law in South Africa, A Quick Reference Guide.

²⁸ Ibid.

²⁹ <http://www.nortonrosefulbright.com/knowledge/publications/52195/differences-between-the-uk-bribery-act-and-the-us-foreign-corrupt-practices-act>

Box 3. Political corruption: Guinea's 'Paradox of Plenty' accessible through the former president's wives?

The recent Guinean mining rights saga is a graphic illustration of political corruption and a blatant example of how politicians are willing to sell off a country's national resources at a fraction of its worth in exchange for handsome personal gain. The Guinean people continue to live in abject poverty, despite vast deposits of high quality iron ore, diamonds and bauxite, amongst other mineral resources.³⁰

In 2008, the mining rights for iron ore at Simandou in Guinea originally granted to Anglo-Australian company Rio Tinto in the 1990s, were unceremoniously stripped by former president General Lansana Conté's and half the rights were granted to BSG Resources (BSGR), a firm owned by Israeli billionaire Beny Steinmetz. For a mere USD165million spent by BSGR in a relatively low risk exploration programme (given the vast deposits in the region), it secured the rights to mine iron ore deposits with an estimated value of USD5billion. Rio Tinto reacted in anger and surprise at the awarding of the concession to BSGR, a company that had no experience at all in iron-ore mining operations. The early rumours were that Beny Steinmetz would simply "flip it"—that is secure the concession and then sell it on at a substantial profit to a firm actually capable of exploiting the resource. This is precisely what he did. In 2009, BSGR sold 51% of its stake to Vale, a Brazilian mining company and competitor to Rio Tinto, for USD2.5billion, generating an incredible windfall, which in no way would reach the Guinean people. Mo Ibrahim, the Sudanese telecom billionaire and high-profile opponent of corruption, famously said of the deal, "*Are the Guineans who did that deal idiots, or criminals, or both?*"³¹

It is reported that all four wives of late president General Lansana Conté, particularly his youngest wife, were actively involved in the mining and business deals in the country, receiving generous "gifts" in return for favours. One commentator noted that "*Whatever people wanted to bring into Guinea, whatever they wanted to take out, they went through one of his wives.*" Claims abound that other high ranking officials have also benefited through various gifts including a gold- and diamond-encrusted miniature Formula One car given to a former government minister. As reported in an article in the New Yorker, General Conté himself referred to his ministers as 'thieves' and once stated, "*If we had to shoot every Guinean who had stolen from Guinea there would be no one left to kill.*"³² General Conté died shortly after the concession was signed over to BSGR.

The current president, Alpha Condé, has instigated several probes into the dealings by international firms in the mining sector, including into the BSGR Simandou deal. The president has appointed multinational teams that include the US FBI, the Guinean government and the French and Swiss police to uncover any corruption or money laundering.³³ If the probe finds against BSGR, the president could re-claim the Simandou rights.

The role of middle men, agents or scouts, in such deals was highlighted in this story. A French national, allegedly acted as a scout for BSGR in Guinea, spending time with, and lavishing gifts on, influential people who fed him information on the concession. He also focused his attentions on General Conté's youngest wife through whom he had access to the General.³⁴ 'Facilitation payment' is the term applied to the fee that politically connected individuals earn for their services, often no more than securing a meeting with a key public official or politician. As with lobbying, the line between this activity and outright corruption is blurred. While the FCPA made exceptions for payment to a foreign official to ensure a routine (non-discretionary) government action, the UK Bribery Act does not except this type of conduct.

³⁰ http://www.newyorker.com/reporting/2013/07/08/130708fa_fact_keefe

³¹ Ibid.

³² Ibid.

³³ BSGR Investigated for Corruption in Guinea Iron Ore Deal by Richard Smallteacher October 4th, 2013, <http://www.corpwatch.org/article.php?id=15893>

³⁴ Ibid.

5. Addressing “wicked” problems

75. Corrupt conduct and anti-competitive conduct have much in common. Economic rent is central to both. The most serious forms of anti-competitive and corrupt conduct are conspiracies against the public and, it is reasonable to hypothesise, both impact disproportionately on the poor. Both reduce economic efficiency and impose draconian economic costs. Both erect barriers to market entry. Both are characterised by conduct that is widely understood to be corrupt or anti-competitive and that is frequently criminal. Both are also characterised by grey areas where social norms and national specificities and, in the case of competition enforcement certainly, complex economic reasoning play a significant role in establishing the boundaries between conduct that is acceptable, even celebrated, and that which is not. And both are wicked problems.

76. We use ‘wicked’ here, not in the sense of ‘evil’ but rather in the sense of ‘intractable’.

77. A wicked problem is one:

... that is difficult or impossible to solve because of incomplete, contradictory, and changing requirements that are often difficult to recognise. The term ‘wicked’ is used, not in the sense of evil but rather its resistance to resolution. Moreover, because of complex interdependencies the effort to solve one aspect of a wicked problem may reveal or create other problems.³⁵

78. Here we are confronted by two wicked problems with intersecting roots, complementary modalities and similar outcomes. We will wrap up our discussion of these problems by attempting to identify whether their intersections and interdependencies also lend themselves to complementarities in measures to combat them. That is to say, there may be instances in which the resolution of what manifests as a competition problem may lie in tackling a complementary corruption problem; or in which a corruption problem may be resolved by addressing a complementary competition problem. Or, indeed, where particular problems can only be successfully tackled by addressing both simultaneously.

79. This approach is already implicit in our preceding analysis of the nature of corrupt and anti-competitive conduct. Hence, it follows from the analysis presented above that corruption may be best tackled by eliminating the rent generated by uncompetitive markets, and hence the incentive and opportunity for corruption. From this perspective corruption is starved of rent-seeking opportunities by the outcomes achieved through robustly competitive markets and by the enforcement of competition rules necessary to ensure that level of competition. But perfectly competitive markets, in which all rent is eliminated, are a theoretical construct and their attainment is not the objective of competition enforcement. Hence rents, and the incentive for corruption, remains with us even in the context of robust competition enforcement.

80. But we also know that the market imperfections that underpin these rents derive in significant part from public regulation and from the discretionary decision making power of public officials. Viewed from this perspective, the first-best approach is to tackle the opportunity for corruption by eliminating unnecessary or excessive regulation, and limiting the exercise of discretion on the part of public servants, thus facilitating market entry and competition and reducing rents, thus lowering the incentive and

³⁵ Wikipedia. This concept stems from Rittel and Webber (1973), where they describe a wicked problem “*As distinguished from problems in the natural sciences, which are definable and separable and may have solutions that are findable, the problems of governmental planning--and especially those of social or policy planning--are ill-defined; and they rely upon elusive political judgment for resolution. (Not "solution." Social problems are never solved. At best they are only re-solved--over and over again.)*” Others have interpreted Rittel’s conceptualisation of the wicked problem as: “*class of social system problems which are ill-formulated, where the information is confusing, where there are many clients and decision makers with conflicting values, and where the ramifications in the whole system are thoroughly confusing.*” Buchanan (1992).

opportunity for rent-seeking. But while there is merit in constantly reviewing the impact and continuing need for specific regulations, we also know that much regulation is essential and socially and economically productive, and that these necessary regulations are as susceptible to rent-seeking as the many regulations that serve little purpose other than that of rent-seeking. So regulation, like rent, will always be with us and policy prescriptions that rely on the chimera of perfectly competitive markets and the elimination of public regulations provide little by way of practical solutions.

5.1 *Competition enforcement and advocacy*

81. In the next section, we approach the two-way causality in the link between competition and corruption and our quest for complementary solutions from the perspective of **competition enforcement and advocacy**. As noted at the outset, competition enforcement and advocacy authorities are dedicated to eliminating the creation of rents generated by anti-competitive conduct. However they recognise the important incentivising role of rents that accrue through pro-competitive conduct. Indeed in the case of intellectual property protection competition authorities recognise that the pro-competitive content of innovation is so central to the competitive process that they are prepared to accept extra-market assistance in protecting the rents generated by innovation.

82. Even so competition authorities remain deeply wary of rents, including those generated by the unilateral conduct of a dominant firm and by unusually expansive patent protection; they are suspicious of rents created by public interventions, especially those that raise the barrier to, and cost of, doing business, but also of selective, highly targeted industrial policy interventions; and they are downright allergic to rents that are earned by turning oligopolistic market structures, structures that may generate robust competition, into collusive platforms.

83. In each of these anti-competitive devices for creating and extending rents, corruption is a potential role-player, and so it follows, that protagonists of competition are natural antagonists of corruption. We accordingly pose the following questions:

- Is there a role for competition authorities in addressing regulations that restrict market access thus compromising competition and generating rents?
- Are there competition-friendly approaches to industrial policy, approaches that strengthen the prospect of generating ‘good’ rent and that minimize rent-seeking opportunities?
- Are bid-rigging cartels protected by corrupt conduct and is there merit in simultaneously tackling horizontal collusion (anti-competitive conduct) and vertical collusion (corrupt conduct)?
- Is certain of the conduct that creates and maintains dominance, and the rent that it generates maintained by mechanisms best addressed by anti-corruption enforcement?

84. We have, in the course of this paper, noted the role played by intellectual property protection in permitting the extraction of monopoly rents, thus incentivising innovation. While the role of IPR in incentivising innovation is actively debated, it is beyond the scope of this paper. The question of patent abuse – manipulating the publicly sanctioned mechanisms for protecting patents – is closer to the concerns of this paper. In particular, the practice of ‘patent ambush’- the practice of deliberately withholding crucial and relevant information on patents from a standard setting process, and then pursuing lawsuits against those who, in attempting to meet the industry standard, find that they are obliged to rely on patented technology – involves a level of deceit that would appear to border on corruption (see the *Rambus* and *Qualcomm* cases).³⁶

³⁶ *Rambus Inc. v. Infineon Technologies AG*, as cited in 548 F.3d 1004 (2008) QUALCOMM INCORPORATED, Plaintiff-Appellant, v. BROADCOM CORPORATION, Defendant-Appellee. Nos. 2007-1545, 2008-1162. United States Court of Appeals, Federal Circuit. December 1, 2008.; http://europa.eu/rapid/press-release_SPEECH-12-453_en.htm

Again patent abuse is a specialised topic and though, like most common forms of corruption, appears to involve the manipulation of the regulatory environment for private gain, it will not be dealt with in this paper.

5.1.1 Regulations, rent seeking and corruption: Is there a role for competition authorities in addressing regulations that restrict market access thus compromising competition and generating rents?

85. We have already said much about the rent seeking generated largely through the creation and administration of the web of regulations that govern business, in particular those that control rights of market access. The direct relationship between high levels of corruption and low levels of competition is particularly clear. Corrupt officials are incentivised to restrict market access or cause market exit because the rents available for appropriation are determined by the level of competition. And so corrupt officials set about reducing competition and corrupt business people are able to generate monopoly rent by inducing public officials to limit access to ‘their’ markets.

Box 4. Red tape and bureaucracy inhibit entry and trade, whilst creating scope for corruption

The presence of corruption is estimated to increase the cost of doing business on average by up to 10% globally.³⁷

In Africa, entrenched corruption is seen as more prevalent than in other parts of the world with estimates of corruption as a percentage of GDP approximately five times larger than global averages, costing Africa around US\$148 billion annually or 25% of continental GDP.³⁸ Extensive red tape in many African countries creates investment and trade barriers for multinationals wanting to do business across the continent. Unnecessary paperwork and regulations also present opportunities for petty corruption by public officials. As Chairman of the large South African-based, continent-wide supermarket chains Shoprite Holdings and Pepkor, Christo Wiese, explains, “*Much more than corruption, it is the stifling red tape in Africa that is inhibiting trade.*”³⁹ Highlighting the extent of red tape in cross border trade, Wiese explains that around 1600 different forms need to be completed in order to move goods from South Africa to Mozambique, a neighbouring country. A World Bank report shows that Shoprite spends around USD20,000 each week on import permits to transport basic food products to Zambia, and applies for around 100 single entry import permits each week, increasing to 300 in peak periods.⁴⁰ Aside from hindering trade and entry, such onerous processes greatly increase the potential for petty corruption by low-level public officials who can be enticed to speed things up for a small price. Indeed what Wiese’s statement – reproduced above - fails to recognise is that excessive red tape is, for a large part, in place *because* of the opportunity it creates for corruption. Some of the regulatory requirements and forms may have once performed a necessary regulatory function but they have been retained in place because a cluster of corrupt public officials – customs officials, health officials, etc. – have developed an interest in keeping the system in place because of the rent-seeking opportunities that it provides. Other pieces of red tape may never have had any function other than to generate a rent seeking opportunity.

The high degree of central planning in India between 1947 and 1990 spawned the term ‘License Raj’ which refers to the extensive regulation, licenses and red tape that was necessary for formal business to set up and operate, particularly in manufacturing. Aside from production being regulated by government, companies would need to go through up to 80 government agencies before being able to produce and bring their products to market. While the economy has undergone significant liberalisation in recent years, manifest in the partial dismantling of the license raj, it is reported that starting a company in India requires the investor to go through 12 procedures, which takes 29 days and costs nearly 47% of income per capita. Obtaining construction permits in India puts a company through 34 administrative steps, which take an average of 196 days at a cost of over 1,528% of income per capita.⁴¹

³⁷ <http://www.weforum.org/node/66473>

³⁸ http://www3.weforum.org/docs/AF10/WEF_AF10_Report.pdf

³⁹ <http://www.bdlive.co.za/business/trade/2013/08/29/red-tape-limits-african-trade-more-than-graft>

⁴⁰ Ibid.

⁴¹ <http://www.business-anti-corruption.com/country-profiles/south-asia/india/corruption-levels/licences-infrastructure-and-public-utilities.aspx>, citing the World Bank *Doing Business Indicators*, 2013.

Box 5. Ease of doing business: Unnecessary and burdensome regulations- a situation rife for corruption?

The *Licensing of Businesses Bill* recently introduced by South Africa's Department of Trade and Industry stipulates that informal street vendors who cannot produce a license stipulated by the Bill are liable to significant fines or up to 10 years imprisonment. While the stated objective of the Bill is to clamp down on illegal trade and trade in counterfeit goods, it has been pointed that all of the mischief that the Bill is ostensibly intended to cure already constitute contraventions of other statutory provisions.⁴²

The time and cost entailed in acquiring yet another license will be onerous, particularly in the context of a country in which the time taken to set up a business is already cause for concern. The penalties for non-compliance with this new license have been described as "*hopelessly disproportional*" and are described by one commentator as "*...like using a sledge hammer to kill a fly. And they haven't identified the fly.*"⁴³ The extortionist and sometimes brutal treatment of street traders by law enforcers, particularly by the Johannesburg Metropolitan Police Department (JMPD), the law enforcement agency that will be responsible for enforcing the Bill in Johannesburg, has been widely condemned by the non-governmental organisations and private sector associations. The Bill is seen, in addition to other concerns, as an avenue rife for further corruption.

In a submission to the Department of Trade and Industry on the Bill, Corruption Watch, an NGO set up to combat corruption, questioned the constitutionality of the Bill and highlighted the vagueness in its drafting, the broad nature of the designation and powers of inspectors and the lack of capacity in local government which is responsible for enforcement of the bill. All of these factors create enormous potential for corruption in a tier of government in which extremely high levels of corruption are already well documented.⁴⁴ In its first nine months of operation, 14% of all reports to Corruption Watch alleged corruption involving officials responsible for enforcing municipal by-laws and those responsible for the issuing a range of licenses. 25% of all reports of corruption received by Corruption Watch alleged corruption in the exercise of municipal functions and responsibilities.

In most instances, the street vendors' only business possessions are their trolleys and their wares, all of which may be summarily confiscated by JMPD officials if a vendor is found not to be in possession of the license provided for in the Bill. Given that many of the products of a typical street trader are perishable, confiscation, even for a short period of time, renders the traders exceptionally vulnerable. Traders have reported that harassment is particularly intense on Friday afternoons when municipal police officers responsible for enforcing trading by-laws are out to make a quick buck before the weekend commences. Margins made by informal street traders are already slim given high levels of competition. Many members of the class of traders who will be affected by this new licensing requirement are immigrants, and so the Bill has been welcomed by associations representing indigenous traders, speaking volumes about the anti-competitive nature of this intervention in addition to its arbitrary nature. It is reported that already – that is prior to the introduction of this new licensing requirement – street vendors are being forced to pay bribes of around USD5 when police raid their stalls, an event that occurred several times each month, off total average monthly earnings of USD250.⁴⁵

In a separate Corruption Watch campaign directed at bribery on the roads in Johannesburg – traffic law enforcement is the responsibility of the JMPD, the very agency that will be responsible for enforcing the proposed new licensing regime – it was found that minibus taxi drivers were willing to continue paying regular, sometimes daily, bribes of approximately USD5 because if this was clamped down on, the traffic officers would contrive to hold them up sufficiently long to reduce their day's output by a single trip, thus eliminating their entire daily margin.

⁴² <http://mg.co.za/article/2013-05-03-00-half-hatched-law-lays-hawkers-low> citing Geordin Hill-Lewis, an MP and an opposition party spokesperson.

⁴³ <http://mg.co.za/article/2013-05-03-00-half-hatched-law-lays-hawkers-low>, citing research director of the independent private sector research company, SBP.

⁴⁴ Written Comments from Corruption Watch on Licensing of Businesses Bill, 2013, 17th April 2013.

⁴⁵ Corruption Watch, "Joburg hawker takes a stand on corrupt cops", 24 August 2012.

Burdensome regulation is both a barrier to entry and to growth for businesses. *Doing Business*, as part of the World Bank and International Finance Corporation's Global Indicators and Analysis unit, captures the ease of doing business by measuring the “*efficiency and strength of laws, regulations and institutions that are relevant to domestic small and medium-sized companies throughout their life cycle.*”⁴⁶ Various proxies are used to measure the ease of doing business, such as time taken to meet regulatory requirements, number of procedures, cost and minimum capital required to start a business and the time and cost required to secure construction permits, to acquire electricity and to register property. Other proxies include the protection offered to investors, the strength of legal rights and depth of credit information required to get access to credit, the level of taxes, the number of documents needed to trade across borders, the ability to enforce contracts and success in resolving insolvency.⁴⁷

Drawing from the *Doing Business* data survey economies are ranked according to the various dimensions (each given equal weight) that generate an index on the ease of doing business in that country. Singapore is ranked 1st, while Chad is in 189th position. A high ranking indicates that the regulatory environment is more conducive to the starting and operation of the business. The rankings for all economies are benchmarked to June 2013. South Africa’s overall ranking (41) is not far off from France’s (38). Zambia, where companies like Shoprite have found it difficult to enter, is ranked 83.⁴⁸

86. The habitual solution for the sort of regulatory provisions that inhibit market access and generate rent seeking opportunities is to ‘deregulate’. Certainly competition authorities should use their advocacy powers to oppose unnecessary regulation and should advocate for, and themselves undertake, regular assessments of the impact of these regulations on competition and on the opportunities that they generate for corruption. Indeed given acute public outrage at corruption, stressing the rent seeking opportunities in regulation may elicit a more immediate response from the public and from the authorities than an approach that focused only on the implications for competition.

87. However the notion of an unregulated or ‘free’ market is a fantasy. For a variety of reasons a significant extent business regulation is essential. Here the best approach is to focus attention on reducing the discretionary element in regulatory decision making. Clear rules that limit discretion on the part of the decision maker and a transparent decision making process will serve to limit opportunities for corruption and the greater certainty generated will limit the impact on corruption.

88. The increasing interest of competition authorities in formal market enquiries may prove to be a particularly effective instrument for addressing and exposing anti-competitive regulation and associated rent-seeking opportunities. These enquiries are, by their very nature, intended to traverse territory well beyond the limits of private anti-competitive conduct, the traditional enforcement concern of competition authorities. Indeed they are more likely to expose anti-competitive regulation and produce advice on regulatory reform than they are to produce evidence of anti-competitive conduct for prosecutorial purposes. An enquiry sensitised to identifying opportunities for corruption may, by advocating for reforms intended to reduce corruption, more effectively serve their mandate to promote competition, than would an enquiry narrowly focused on barriers to competition. Our remarks on Armenia – see Box 10 - exemplify an instance where an enquiry to determine anti-competitive outcomes in key markets would successfully promote competition if sensitive to corrupt administrative conduct.

⁴⁶ <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Miscellaneous/What-is-Doing-Business.pdf>. Doing Business does not measure security, macroeconomic stability, corruption, the level of skills, or the strength of financial systems.

⁴⁷ <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB14-Chapters/DB14-Ease-of-doing-business-and-distance-to-frontier.pdf>

⁴⁸ <http://www.doingbusiness.org/rankings>

5.1.2 *Competition-compatible industrial policy: Are there competition-friendly approaches to industrial policy, approaches that strengthen the prospect of generating 'good' rent and that minimise rent-seeking opportunities?*

89. As highlighted in Section 2, industrial policy and support programmes are designed to secure rents for the firms or sectors at which they are targeted. But on-going state support can lead to entrenched dominant firms or groups of firms that abuse their positions to prolong and deepen rent generation, not least through corrupt dealings with public officials that oversee the implementation of these programmes.

90. Industrial policy, more so than most other government interventions, is negatively viewed in the rent-seeking literature. Even protagonists of industrial policy have questioned the wisdom of pursuing interventionist industrial policies, not least because of their susceptibility to corruption. Dani Rodrik (2007) asks:

“Consider a set of policy interventions targeted on a loosely-defined set of market imperfections that are rarely observed directly, implemented by bureaucrats who have little capacity to identify where the imperfections are or how large they may be, and overseen by politicians who are prone to corruption and rent-seeking by powerful groups and lobbies. What would your policy recommendations be?” (p1).⁴⁹

91. Rodrik highlights that there are two practical objections to industrial policy. The first is that government is not able to successfully pick winners given large information asymmetries.

92. The second concern, and the one that is central to the concerns of this paper, is that industrial policy is “*an invitation to corruption and rent seeking*” (p11), where the private sector focuses its attention on extracting rents instead of competing on the merits and where preferential policies may be implemented simply as a means of transferring income to politically connected groups.

93. Rodrik however argues that the discussion that this should provoke is not whether government should intervene through various policy measures (not limited to industrial policy) but rather how it implements these policies. He argues that despite the disdain with which industrial policy is often regarded, it is possible to design programmes in a manner that realises their stated economic and social objectives while curbing self-interested rent-seeking behaviour or, as Rodrik refers to it, while ‘*keeping agency problems in check*’ (p45). He suggests certain ways in which policy can be designed, including through constructing a system which better understands, and allows for information gathering or ‘discovery’, of the spillovers and the constraints markets face through collaboration and co-ordination between government and the private sector. Rodrik explains that such co-ordination⁵⁰ would allow for the identification of major bottlenecks, would assist in designing effective interventions and in conducting regular performance evaluations.

94. Rodrik emphasises that successful implementation of such a policy requires both the inducement of a carrot and the discipline of a stick. The critical disciplining stick is the prospect of withdrawing support in the event of non-performance in competitive markets. He contrasts the East Asian and Latin American approaches. The former penalised firms that did not abide by the conditions for state support – largely linked with measured performance in competitive export markets – by the withdrawal of the support. Latin American industrial policy did not make use of a stick, the upshot of which was that unproductive firms remained in the system. He also emphasises the need to review, monitor and evaluate the programme, so that even if government is not able to pick winners, it should at least have the capacity to let the losers go.

⁴⁹ Rodrik (2007).

⁵⁰ Co-ordination could include deliberation councils, supplier development forums, “search networks,” investment advisory councils, sectoral round-tables or “self-organizing industry investment boards.” (Rodrik, 2007).

95. Finally, accountability of policy makers and implementers is crucial, including through increased transparency, where any request made to government by the private sector for assistance should be disclosed to the public so that the decision making process and criteria, and any anomalies therein are clearly visible. Regular disclosure of the expenditures under various industrial policy instruments would also assist in detecting corrupt activities.

96. Rodrik further argues that a balance needs to be struck between the full autonomy of the bureaucrat (from private sector businessmen) and the full ‘embeddedness’ of the bureaucrat to ensure that a system is in place which minimises corruption. The term embeddedness is drawn from Peter Evans’ terminology, where he suggested that industrial policy-making has to be embedded within a network of linkages with private groups.⁵¹ While full autonomy of the bureaucrat would reduce corruption by insulating the public official from the private business person, it would not, argues Rodrik, allow for the accumulation of knowledge on the part of the bureaucrats that would produce the sort of incentives required by the private sector. At the other end of the spectrum, full embeddedness of the bureaucrat would likely result in the capture of the policy maker and the public official by private interests.

97. Like Rodrik, Aghion *et al* (2012)⁵² emphasise that the debate is not whether there should be industrial policy, but rather how such policy should be designed and implemented to ensure that it is competition-friendly and that it is not captured by the narrow interests of a firm or small group of firms. They note that the more competitive a sector is, the less firms in the sector will gain from lobbying government for support.

Box 6. Corruption underpins industrial policy failures

While there have been outstandingly successful industrial policy interventions – with the Asian tigers the much disputed poster boys for the merits of industrial policy - there have been numerous failures. Several examples of these failures come from industrial policy efforts in Sub-Saharan African and Latin American countries, with poor project planning, political interference and corruption being some of the reasons attributed to the failure.

As highlighted by Robinson (2009) and Gray (2013), understanding the political economy and the political settlement of the time is crucial in understanding the constraints and successes of industrial policy. Robinson argues that promoting industrialisation is an endogenous outcome of the political choices of a society. In Tanzania, the relationships between the state and private capital were apparent at the time of liberalisation. A large number of corruption cases came to light which highlighted the close relationship between the ruling party and key businessmen (Gray and Khan, 2010, as cited in Gray, 2013). Privatisation efforts did not result in less corruption and it did not address the ‘*deeper political constraints on the implementation of industrial policy*’. (p193). An example provided by Gray (2013) highlights the ongoing corruption in Tanzania embedded in industrial policy initiatives. Loans, including a subsidised loan through the National Social Savings Fund (NSSF) of US\$10 million, were given to General Tyre East Africa Ltd to assist in the purchase of raw materials to restart production. Auditors found six years later, when production did not kick off, that the loan had been wasted away by management (Mikaili, 2011 as cited in Gray, 2013).

In Argentina, the industrial policy that followed Juan Perón’s rise after 1943 supported the interests of the political elite and did not create the incentives needed to stimulate industrialisation. Government was more interested in nationalistic and populist policies than in industrialisation. Such policies highly favoured the traditional elite (the owners of land) and institutions were developed to create and extract rents from the indigenous population, creating very high levels of inequality.⁵³

⁵¹ Evans (1995) as cited in Rodrik (2004).

⁵² Aghion, Dewatripont, Du, Harrison and Legros (2012).

⁵³ Ibid.

98. Industrial policy targeted at encouraging investment in physical, telecommunications and resource-related infrastructure is seen as critical for economic development. It may also be the form of industrial policy least vulnerable to capture by particular firms and sectors. However, infrastructure projects are prone to both anti-competitive conduct and corruption. Large-scale infrastructure projects are susceptible to bid rigging. Awarding telecommunication licences or spectrum is open to corruption and collusive tendering, and could prevent the entry of effective competitors. Resource-related infrastructure may also be prone to resource rent exploitation, exclusionary and exploitative behaviour.

99. The next section highlights the interface between competition and corruption in public procurement, particularly in the provision of industrial infrastructure.

5.1.3 *Cartels/Public procurement: Are bid-rigging cartels protected by corrupt conduct and is there merit in simultaneously tackling horizontal collusion (anti-competitive conduct) and vertical collusion (corrupt conduct)?*

100. As we outline in Box 7, participation in “hard-core” cartels, the quintessential competition law contravention, will also fall foul of many standard anti-corruption laws. They are conspiracies against the public for private material gain and particularly so when bids for supplying goods or services to the public sector, such as in the case of large scale infrastructure projects, are rigged. This is conduct which directly and purposefully undermines a purchasing methodology which is designed to be fair and transparent in order to produce competitive outcomes. Where bid rigging involves the winning bidder paying a consideration to the losing bidder – this may involve a direct cash payment or an undertaking to subcontract a portion of the contract to the loser - which typically occurs in the case of bids for large, lengthy lumpy projects in the construction and civil engineering markets, the key elements necessary to prove corruption are present.

101. The penalties for bribery – in this case the element of bribery is constituted by the payment or other form of consideration made to the bidder that has agreed to lose - are typically more onerous than the penalties for competition offences and obviously so in the many countries in which cartels are not subject to criminal sanction. While criminal penalties undoubtedly fit the offence of collusion, there are, in a great many competition law jurisdictions, cogent arguments against criminalising competition law statutes. These arguments against criminalisation of collusion generally revolve around the higher standard of proof required, the impact that this step would have on leniency programmes and the consequences of involving ill-equipped, over-burdened and frequently highly corrupted criminal prosecutors and law enforcement agencies in enforcing competition law.

102. It is not clear that all of these pitfalls of criminalising cartel conduct would be avoided by using anti-corruption law rather than competition law to prosecute responsible individuals in cartel cases, while retaining exclusive jurisdiction for the competition authorities – and therefore administrative sanctions - in pursuing the firms participating in cartels. However if the criminal justice authorities, acting in co-operation with the competition authorities, were to selectively invoke the anti-corruption laws to prosecute individuals involved in the most egregious and damaging cartels which had the best prospect of success in securing a conviction for corruption – and rigging public sector bids would be a strong candidate – and were to announce a prosecutorial policy to this effect, it would have the effect of deterring targeted cartel conduct and would be a credible threat. It would not criminalise the competition statute and so would not disincentivise leniency applications in cartels that did not involve public sector bid rigging.

103. Moreover there appears to be a dimension of ‘pure’ corruption at play in public sector bid rigging – particularly those that involve large infrastructure projects - that is not as frequently present in the case of many other cartels. It is certainly unlikely to be a feature of collusive conduct in final consumer goods markets. We refer here to the element of vertical collusion, where the cartel is effectively protected by

collusion between, on the one hand, the purchaser – for example, key members of a public sector tender committee – and, on the other, the cartel. This is an offence wholly separate from the horizontal collusion with which competition enforcers are generally engaged. It is a clear case of corruption but one that consolidates the cartel by reducing the prospect of detection.

104. While the vertical collusion – in other words, the element of bribery – is not within the jurisdiction of the competition authorities, there is a strong incentive for the competition law enforcers and the agencies enforcing anti-corruption laws to co-operate. Indeed there are strong arguments for requiring the competition authorities to alert the anti-corruption enforcement agencies to suspected or proven cartel conduct in all cases of public sector bid rigging. Competition law enforcement officials should be trained to recognise corruption red flags, and anti-corruption officers to recognise collusion red flags.

105. Leniency programmes which presently focus on encouraging cartel members to expose and provide evidence and testimony against fellow cartel members, should be extended by offering leniency to those who provide information on the cartels co-conspirators on the purchasing side. Just as it makes good sense to offer leniency to the member of an organised crime syndicate in order to secure conviction of the corrupt senior police officer without whose co-operation elaborate, large scale organised crime would be highly vulnerable to detection, so the effort to stamp out public sector bid rigging may be best served by ridding the public sector of the corrupt procurement officer who helps ensure that the rigged tender remains undetected.

**Box 7. Recent unearthing of widespread construction inputs
and construction projects cartels in South Africa**

Through a Netherlands and UK-styled fast-track settlement process launched in February 2011, widespread collusive tendering in the construction industry was unveiled and settled by the Competition Commission of South Africa. By June 2013, all 15 fast-track agreements reached between construction companies had been approved by the Competition Tribunal, amounting to penalties of ZAR1.46 billion (USD146 million) collectively. Over 300 contracts were found to have been rigged in and outside South Africa to a value of around R46 billion (USD4,6 billion).

Most of the projects rigged were large-scale public sector projects, such as the World Cup stadiums and road construction projects. The construction companies engaged in bid-rigging, cover pricing and compensation payments as part of their strategies, including paying ‘losing’ companies compensation reflected as ‘plant hire’ fees in their books.

In a submission to the Competition Tribunal, Corruption Watch maintained that “*individuals who manipulate a tender process by way of cover pricing or any other form of collusion in contravention of the Competition Act may in fact also be in contravention of sections 12 and 13 of our anti-corruption statute- PRECCA (Prevention and Combating of Corrupt Activities Act). And thus liable to be prosecuted under this statute.*” Criminal sanctions, including imprisonment, are attached to this contravention, and can be extended to firms and individuals that agree to put in a cover price to give the illusion of competition. Under Section 34 of PRECCA, any individual personally involved in bid rigging negotiations can be held accountable for failure to report corrupt or suspected corrupt activity in excess of ZAR100 000 to the police if the person ought reasonably to have known about the corrupt activity. A fine or up to ten years in prison could result. Pursuing such conduct through corruption legalisation may act as a greater deterrence to future conduct in situations where the administrative, civil and reputational damage is insufficiently deterrent.

Similarly, the 35-year old cartel in major inputs into construction projects, concrete products (concrete pipes, culverts and manholes), stands out. This was a well-coordinated and well-documented price fixing and project allocation cartel, which extended beyond the borders of South Africa. Projects were mainly allocated on a contract-by-contract basis, where lists of available jobs and acceptable ranges of discounts were decided and monitored on a monthly basis. It is hardly credible that a cartel involving such elaborate and complex rules – necessary to ensure that each of the cartel members were appropriately compensated lest they should elect to leave the cartel – could have remained undetected for 35 years without the co-operation of key individuals on the purchasing side.

Box 8. Zambia's Farmer Input Support Programme (FISP)

The Zambian government since 2002 has provided fertilisers and seed at heavily subsidised prices to farmers through the FISP. This programme has received a large proportion of the government's budget allocation to poverty reduction but has been plagued with allegations of bid rigging and market allocation between two input suppliers, Omnia Zambia Limited and Nyiombo Investments Limited, who were the winners of the government's FISP tenders between 2007 and 2011. The Competition and Consumer Protection Commission (CCPC) fined each company five per cent of their respective annual turnovers. According to the CCPC, the cartel was estimated to have cost the economy more than USD20 million over the years these two companies had been supplying fertiliser to the Government.

In addition to collusion in the supply of inputs for the FISP, widespread corruption is reported in the awarding of the assistance to farmers, where, contrary to the objectives of the programme, the beneficiaries appear to be wealthy farmers and the administrators of the programme who are responsible for the distribution of the support to qualifying and deserving farmers. As noted by a politician, "*Agriculture camp officers and teachers are the people who have benefited a lot in the FISP (Farmer Input Support Programme), that's why today most of them are driving expensive cars and all what people are good at is to blame government when they really know the culprits.*"⁵⁴

Given the widespread corruption and competition issues throughout the FISP, the CCPC has been collaborating closely with the anti-corruption agency. The Anti-Corruption Commission (ACC) also initiated investigations into Omnia and Nyiombo for under-hand methods in acquiring FISP fertiliser supply contracts.

The implementation of an FISP e-voucher system for fertiliser distribution in the 2013/14 season to 10 districts was conceptualised to reduce the widespread corruption. The e-voucher system would make use of mobile phone delivery and tracking, eliminating the need for a middleman, which was where the main source of corruption was seen to lie as well as eliminating the use of paper vouchers. The roll out of the system was subsequently delayed given reported inadequate logistics.⁵⁵ Opposition political parties have criticised the extensive and expensive training programs held on the e-voucher system and workshops for stake holders, only for it to be delayed. After a tender for the supply, delivery installation and commissioning of the FISP Electronic E-Card voucher system and ICT equipment was advertised in a national newspaper, government halted the roll out citing logistics concerns.⁵⁶

106. There are numerous examples of corruption and competition problems in telecommunication licensing. Certain forms of competition *for* the market, such as the beauty contest method for selection between competing bids - whereby a committee made up of government officials selects winners based on meeting certain pre-determined criteria - are more prone to corruption than others, such as auctions. (Binmore and Klemperer (2002)). Indeed they argue that government officials may prefer a beauty contest precisely because it might allow for greater discretion on the part of the decision makers and hence greater capacity for rent-seeking. On the other hand, an auction process has at its core a competitive bidding process, which is not present in a beauty contest.⁵⁷

⁵⁴ http://www.postzambia.com/post-read_article.php?articleId=34229

⁵⁵ <http://www.agriculturalreviewonline.com/index.php/crops/415-zambia-shelves-e-voucher-system-for-farmers>

⁵⁶ <http://zambianeye.com/archives/15884>

⁵⁷ Prat and Valletti (2000).

Box 9. Auctioning of licences in the telecommunications sector

Corruption and anticompetitive allegations have tainted several auctions and awarding of telecommunications licenses.

In 1999, the Nigerian Communications Commission cancelled the publicly advertised beauty contest process to award four national GSM (Global System for Mobile Communications) licences for USD100 million. Following allegations of irregularities in the qualification process and the potential corruptibility of such types of processes, particularly given the history of rampant corruption in Nigeria, the government was concerned that foreign interest in participating in the bid would be deterred. Instead, a combined ascending bid and sealed bid auction was implemented.⁵⁸

India's licensing of 2G spectrum in 2008 was riddled with corruption allegations, and in February 2012, all of the 122 issued mobile licences to eight companies were cancelled by the Supreme Court of India. Licensing mobile spectrum took different forms over time in India, including beauty contests, auctions, up-front payments to the state or on a first-come-first-serve basis. It was alleged that the 2G licence awarding process, which was on a first-come-first-serve basis, favoured certain companies in that they were given advanced (private) notice of a change in the deadline. Further, companies submitted false statements of their financial position. The Supreme Court found that the Minister of Telecommunications was involved in the favouritism and that an important national asset was 'virtually gifted away'. He was subsequently imprisoned. 85 of the 122 licences were granted to new entrants, several of whom sold on the licences immediately for a handsome windfall. Not one of the new entrants complied with their obligations of rolling out a network within a year. The estimated cost of the botched allocation was between USD8 billion and USD20 billion, although these figures are contested.⁵⁹

Despite following an auction system, the Indian 3G auction in 2010 was not short of controversy either. The state owned operator, BSNL, alleged that the bidding process was rigged by three other operators, Bharti Airtel, Vodafone and Idea, to ensure that at least one company got 3G airwaves in every part of India without having to compete with each other and that they deliberately suppressed the bidding price. Bharti, Vodafone and Idea won 3G airwaves in respective regional 'circles' and then privately entered into 3G roaming pacts between them. This allowed them to have a national footprint. BSNL claimed that the pact between Bharti, Vodafone and Idea were in violation of licence conditions. The Department of Telecommunications is also of the view that the pacts are in breach of the bidding conditions, and that subleasing of 3G networks should have been expressly forbidden.⁶⁰

In Italy, five licenses were originally supposed to be awarded through a beauty contest, but then following a government reshuffle in May 2000, it was decided that a simultaneous ascending auction process would follow after a pre-qualifying beauty contest phase. The auction was deemed unsuccessful, with far lower than expected revenue being raised and allegations of anticompetitive conduct. A multi-round auction ensued, where bidders made their respective bids confidentially, but after each round, a list of all participants and their current bids was announced to each bidder. This could have facilitated collusion. Players subsequently pulled out at early stages of the auction and had this been known earlier, the number of licences offered could have been reduced and sold at a higher price generating greater revenue. Speculation was that this was a deliberate tactic. Blu, an incumbent Italian telecom operator, who pulled out after two rounds, may have agreed to receive some sort of compensation payment from the others. No evidence of anticompetitive conduct was found however, and the case was closed in July 2001.⁶¹ A further account of the successes and failures of the Italian auction and other 3G auctions in Europe can be found in Klemperer (2002).

⁵⁸ Nahlik and Jamison (2007).

⁵⁹ <http://www.economist.com/node/21547280>

⁶⁰ http://articles.economictimes.indiatimes.com/2013-04-26/news/38843536_1_3g-roaming-pacts-bharti-airtel-apex-court

⁶¹ Prat and Valletti (2000) and Kendler (2002).

107. Practices designed to reduce the incidence of corruption in procurement processes, such as increased transparency which allow for greater scrutiny of decisions taken by public officials, while limiting vertical collusion, could arguably facilitate collusion between competing bidders.⁶²

108. In evaluating corruption and competition in procurement auctions, Compte, Lambert-Mogiliansky and Verdier (2005) argue that corruption can facilitate price collusion between firms when there are resubmission opportunities for tenders (by, for example deliberately allowing the favoured firm to re-adjust its bid) which provides an opportunity to enforce price collusion between firms as they consult with each other prior to re-submission. Sealed-bid tenders on the other hand, where only a single and final bid is allowed to be confidentially submitted, is less susceptible to collusion.⁶³

5.1.4 *Dominance/entry barriers: Is some of the conduct that creates and maintains dominance, and the rent that it generates, maintained by mechanisms best addressed by anti-corruption enforcement?*

109. Corruption plays a significant role in creating barriers to entry, perpetuating the dominance of certain firms or groups of firms. Where the underlying basis for dominance is corruption, it will generally be preferable to attack the cause of market dominance rather than utilising competition law to curb abuses of that dominance.

Box 10. Corruption undermining competitive outcomes through creating barriers to entry into Armenian markets⁶⁴

Armenia is a highly specialised, landlocked open economy which, for a variety of geo-political reasons, has only one effective border post through which exports and imports pass. Incumbent importers of key products have captured the customs service at this border post by the simple expedient of bribing customs officials to massively undercount their imports. The upshot is that the actual import duty payments are a fraction of that which they would be required to pay but for this deliberate undercounting. This corruptly acquired tax exemption naturally constitutes a significant barrier to entry and is the source of unassailable power in a range of important markets which generates massive rent, a fraction of which is paid to the corrupted customs officials. These rents provide the beneficiaries – the Armenian oligarchs – with the resources that enable them to corrupt other aspects of Armenian public life. Given the openness of the Armenian economy, the systematic undercounting of imports significantly understates the size of the national economy and so deters investment inhibiting the economic growth that Khan identifies as a crucial basis for overcoming corruption.

110. **Privatisation**, ostensibly designed to suppress state-induced rents, has frequently produced highly anti-competitive outcomes in the form of private monopolies. This is widely attributed to multiple objectives in the privatisation and, particularly, to the desire to maximise the price of the asset. In fact failed privatisation initiatives – failed in the sense of producing anti-competitive outcomes – are at least as likely to be attributable to corruption as to flawed policy.

⁶² A fuller discussion of this can be found in OECD Roundtable on Collusion and Corruption in Public Procurement 2010.

⁶³ OECD Roundtable on Collusion and Corruption in Public Procurement 2010.

⁶⁴ Lewis (2012), p 277 to 279.

Box 11. Former state ownership, privatisation, maintenance of entrenched dominant positions – the South African and Latin American experience

In South Africa, powerful conglomerates have shaped the development trajectory of industry, and even though their power has been somewhat diluted over the years, the economy has not diversified away from energy and resource-intensive industries formerly dominated by these conglomerates (termed by Fine and Rustonjee (1996) as the minerals-energy complex (MEC)). Strong linkages developed between these sectors and related industries (such as the financial sector) under apartheid industrial policy. In the South African experience, Makhaya and Roberts (2012) suggest that it is not only the political connections of the incumbents in these sectors that serve to restrict entry but also their strategic behaviour, including through vertical integration and leveraging market power into related markets, that allows entrenched dominant positions to be maintained. Makhaya and Roberts highlight how some South African firms have been able to shape the new regulatory frameworks in their favour, for instance, the telecommunications regulator, who is largely considered ineffective partly as a result of the influence of the incumbent Telkom; the fuel regulatory framework that has continued to protect the incumbent oil companies, including the former state-owned company, Sasol; and the food sector, where the power and influence in the value chain of the conglomerates (frequently former co-operatives) has moved to processing and providing agricultural inputs and services from primary production. Makhaya and Roberts argue that the elite (incumbents), in pursuit of maintaining the status quo, resisted and deliberately delayed changes, including entry, to protect their rents. This is done through, *inter alia*, extensive and prolonged litigation in competition proceedings.

In Latin America, large-scale privatisation programmes involving utilities and transportation companies amongst other industries were tainted by improper conduct at various stages of the privatisation process. For example, in Argentina, the bidding process for the privatisation of the highways was designed by officials who held stakes in the companies that acquired the highways; in Venezuela, it was alleged that the Minister of National Investment deliberately ensured that a major bank was undervalued in return for a payoff. As was the case in South Africa, the privatisation process did not result in less concentrated markets in telecommunications in Argentina. This was also the experience of the Chilean electricity utility. Weak regulatory oversight – regulatory regimes often compromised through lobbying by the very regulated firms - in each of these industries resulted in monopoly rents being maintained by private owners. Kaufmann and Siegelbaum (1997) explain that firms with market power post-privatisation are likely to maintain close relationships with the state, and therefore the design of the privatisation process and the strength of the regulatory framework at the time of privatisation are important.

6. Conclusion

111. There are key and manifest conceptual and practical interfaces between corrupt and anti-competitive conduct. The economics literature that seeks to encapsulate both problems has largely been confined to correlating the two costly phenomena. Given the sheer scale of the social and economic costs generated by each, it is perhaps surprising that so little attention given to enforcement interfaces, to identifying interventions by the competition enforcement authorities and the anti-corruption authorities that may simultaneously resolve aspects of both problems.

112. This paper highlights the underlying conceptual interface – the issue of economic rent and rent-seeking – between competition and corruption; it surveys the literature that seeks to identify correlations between levels of competition and corruption; it categorises the various types of corruption. Finally it tentatively examines possible enforcement interfaces that may enable the respective competition authorities and anti-corruption authorities to better tackle the ‘wicked’ problems that each is tasked with resolving. Circumstances where the optimum solution to a competition problem may lie in tackling a complementary corruption problem, and vice versa, are explored, as well as areas where the problems are most effectively solved through a simultaneous handling of both the competition and corruption issues. This includes the role of competition authorities in advocating against unnecessary regulation and the resultant opportunities for rent seeking and in advocating for ‘competition-friendly’ industrial policy.

113. This final section is the central contribution of this paper and one that those represented at this Global Forum are best placed to interrogate and elaborate.

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