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**LATIN AMERICAN COMPETITION FORUM**

**Session III - Improving Effective Public Procurement: Fighting Collusion and Corruption**

**Contribution from Peru**

**18-19 September 2012, Santo Domingo, Dominican Republic**

*The attached document from Peru is circulated to the Latin American Competition Forum FOR DISCUSSION under Session III of its forthcoming meeting to be held on 18-19 September 2012 in Santo Domingo, Dominican Republic.*

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English - Or. English



## LATIN AMERICAN COMPETITION FORUM

-- 18-19 September 2012, Santo Domingo (Dominican Republic) --

### Session III – Improving effective public procurement: fighting collusion and corruption

-- CONTRIBUTION FROM PERU <sup>1</sup>---

#### 1. Size and policy objectives

1. Public procurement amounted PEN 43 298,04 millions (approximately, USD 15 716,17 millions) in 2011, which represents 8,9% of the Peruvian GDP of that year.<sup>2</sup>

2. Public procurement is regulated by the State Procurement Law (approved by Legislative Decree 1017)<sup>3</sup> and its Regulations (approved by Supreme Decree 184-2008-EF)<sup>4</sup>. Article 4 of the former states that the principle policy objectives of public procurement are: (i) promotion of human development; (ii) morality; (iii) free competition; (iv) impartiality; (v) reasonableness; (vi) efficiency; (vii) advertising; (viii) transparency; (ix) economy; (x) technological effect; (xi) fair and equal treatment; (xii) equity and (xiii) environmental sustainability.

#### 2. Corruption

##### 2.1 Cost of corruption

3. According to a study by the Ministry of Justice the cases of corruption related to public procurement represent up to 30% of the total amount spent in public procurement<sup>5</sup>; i.e. around PEN

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<sup>1</sup> This is a condensed and updated version of the document “Collusion and Corruption in Public Procurement – Contribution from Peru”, which was prepared as a contribution for 2010 Global Forum on Competition.

<sup>2</sup> Source: <http://www.seace.gob.pe/>.

<sup>3</sup> Amended by Law 29873, issued on May 31<sup>st</sup>, 2012.

<sup>4</sup> Amended by Supreme Decree 138-2012-EF, issued on August 6<sup>th</sup>, 2012.

<sup>5</sup> MINISTERIO DE JUSTICIA DEL PERÚ (2007). *Plan Nacional de Lucha contra la Corrupción y Ética Ciudadana*. Grupo de Trabajo (D.S. N° 004-2006-JUS).

12 989,41 millions in 2011 (approximately, USD 4 714,85 millions). Furthermore, Kaufmann et. al. (2010) report that Peru ranks 106<sup>th</sup> among a sample of 210 countries when considering the control of corruption.<sup>6</sup>

## 2.2 *Factors which facilitate corruption*

4. The Ministry of Justice<sup>7</sup> identified three types of factors which enable the emergence of corruption in Peru: formal, cultural and material factors. Among the *formal factors*, the following are mentioned: the lack of a clear demarcation between the public and private spheres, the existence of a legal system that is not adequate to the national reality and the practical ineffectiveness of public institutions. Some of the most important *cultural factors* identified in the document are: the wide social tolerance for the enjoyment of privileges due to a prevalence of private gain versus civic morality, the existence of a widespread culture of illegality as a way of functioning and the lack of change in the organizational and regulatory systems despite the evolution of States. And among the *material factors*, the following are identified: the gap between the resources of public administration and social dynamics, the impunity gap between actual and formal responsibility of public officials and the gap between actual social power and formal access to political influence.

5. Additional factors that might help corruption mentioned in the same study are the following: the low probability of detecting corrupt acts, the slight punishment for corrupt activities and the absence of social sanctions for corrupt individuals; the lack of independence of judges responsible for monitoring political corruption and the lack of respect for judicial decisions; the weak credibility of the institutional order; the lack of a public career which promotes sound institutions and the compliance of the duties of public employees, and the informality that characterizes the Peruvian economy, which is closely related to the high cost of complying with the law.

6. Finally, the lack of transparency in the management of financial resources in regional and local governments (which is possible due to the fact that regional and local governments are not obliged by law to publish their financial accounts) is an additional factor that might facilitate corruption in public procurement. This situation is exacerbated by the fact that people who work in regional and local governments is not properly trained and some of them are not familiarized with the State Procurement Law, especially in local governments.<sup>8</sup>

## 2.3 *Fight against corruption*

7. In Peru, several reforms have been implemented in order to increase transparency in public procurement. One of the most important initiatives in this regard was the implementation of the National Plan to Combat Corruption<sup>9</sup>, which includes several provisions to increase transparency in the government functions. The plan includes seven goals:<sup>10</sup>

<sup>6</sup> KAUFMANN, D., A. KRAAY and M. MASTRUZZI (2010). The Worldwide Governance Indicators: Methodology and Analytical Issues. Draft Policy Research Working Paper. The World Bank Institute. Available in: <http://info.worldbank.org/governance/wgi/pdf/WGI.pdf> (Last visited: August 2<sup>nd</sup>, 2012)

<sup>7</sup> Ministerio de Justicia del Perú (2007). Op. Cit.

<sup>8</sup> According to Juan Carlos Rivera, official of the Presidency of the Council of Ministers and member of the Multi Sectoral Working Group monitoring the National Plan to Combat Corruption, interviewed on December 14<sup>th</sup>, 2009.

<sup>9</sup> Established by Supreme Decree N° 004-2006-JUS, issued on January 25<sup>th</sup>, 2006.

<sup>10</sup> PRESIDENCIA DEL CONSEJO DE MINISTROS (2008). *Plan Nacional de Lucha contra la Corrupción. Un compromiso de todos.* Available in: <http://can.pcm.gob.pe/mwg-internal/de5fs23hu73ds/progress?id=bF9QW5sQ7L>

- Promoting the strengthening of the System to Combat Corruption.
- Institutionalizing good governance practices, ethics, transparency and the fight against corruption in public services.
- Articulating an effective and comprehensive legal strategy against corruption
- Promoting practices in the business sector to combat corruption
- Promoting the active participation of media in combating corruption
- Obtaining the commitment of society to actively participate and monitor the fight against corruption
- Developing concerted international efforts to combat domestic corruption.

8. As a result of the application of the National Plan, several laws have been enacted in the last few years.<sup>11</sup> Some of the most important prevented measures undertaken are the enactment of Law 26850 (State Procurement Law) and Law 27806 (Law of Transparency and Access to Public Information). And among the most important sanctioning measures, we have the creation of the Directorate of Police Corruption, the enactment of Law 27978 (Law of Leniency) and the establishment of Decentralized Anticorruption Public Prosecutor's Offices.

9. Furthermore, the High Level Anti-corruption Commission<sup>12</sup> was created in January 2010 with the objective of acting as a coordination body among the main branches of government, constitutionally autonomous bodies, representatives of regional and local governments, business associations, political actors and civil society. It is in charge of monitoring the implementation of the National Plan.

#### **2.4 Procurement processes**

10. Firms are not required to certify that they have not bribed an official during the procurement process. Nonetheless, they are required to submit a sworn statement in which they declare under oath that:

- They are not prevented from participating in public procurement processes according to what is established in Article 10 of the Public Procurement Law.
- They know, accept and submit to the terms, conditions and procedures of the selection process.
- They are responsible for the veracity of the documents and information presented by them in the selection process.
- They promise to maintain their bids during the selection process and to sign the contract in case they win the process.
- They know the sanctions contained in the Public Procurement Law, its Regulations and Law 27444, General Administrative Procedure Law.

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<sup>11</sup> Ministerio de Justicia del Perú (2007). Op. Cit.

<sup>12</sup> See: <http://can.pcm.gob.pe/>

11. Regarding the sanctions that can be applied to **individuals** who have engaged in corruption or bribery (either as perpetrator or as participant in the offense), Article 28 of the Penal Code establishes the following sanctions: imprisonment, restriction of freedom, limitation of rights and fine. It should be mentioned that the length of imprisonment depends on the offense described in each particular case. For instance, in the case of collusion, the sentence of imprisonment shall be neither less than three nor more than 15 years<sup>13</sup>; while in the case of incompatible negotiations or improper use of office, the sentence of imprisonment shall be neither less than four nor more than six years<sup>14</sup>. Furthermore, according to the provisions of Article 92 of the Penal Code, together with the sentence, the aggrieved party is entitled to initiate civil proceedings against the offender in order to claim for civil damages.

12. Regarding the sanctions that can be applied to **firms** that have engaged in corruption or bribery, Article 105 of the Penal Code establishes that the Judge should apply all or some of the following sanctions: (i) closure of premises or facilities, temporarily or permanently<sup>15</sup>; (ii) dissolution and liquidation of the firm; (iii) suspension of the activities of the society, association, trust, cooperative or committee for a term which does not exceed two years, and (iv) prohibition on the firm to perform in the future activities of the class of those in whose practice the crime was committed, aided or concealed.

13. Finally, it should be mentioned that there are Special Criminal Courts in charge of prosecuting crimes against public administration and bribery of officials. These courts are also in charge of prosecuting offenses committed by public officials engaged in a public procurement processes.<sup>16</sup> The Peruvian Competition Authority (CA)<sup>17</sup> does not have any power in the prosecution of corruption cases.

### 3. Collusion

14. In addition to the factors identified by the economic theory, such as concentration, the existence of barriers to entry, cross-ownership and other links among competitors, regularity and frequency of orders, low buyer power, the existence of a stable demand, product homogeneity, symmetry among firms, etc.,<sup>18</sup> additional factors that might facilitate collusion in procurement processes in Peru are the following:

- *Difficulty in monitoring bidders and their actions.* While in principle, detailed information about the procurement process (such as the bidder's name, number of bidders, bids, etc.) should exist in the records of the procurement process; this information is not always readily available for the CA and/or third parties. Furthermore, if the CA needs this sort of information, it should make a formal requirement to the Public Procurement Agency and it is not clear whether the information will be easily to process for the Public Procurement Agency;

<sup>13</sup> According to Article 384 of the Penal Code, the official or public servant who, in contracts, supplies, auctions, price competitions or other similar transaction in which he is involved because of his office or because he is part of a special committee, defrauded the State or any State entity or agency, according to the law, arranging with stakeholders in agreements, adjustments, liquidations or supplies shall be punished by imprisonment of not less than three nor more than 15 years.

<sup>14</sup> According to Article 399 of the Penal Code, the official or public servant who improperly, directly or indirectly or through a simulated act, is concerned, for oneself or a third party, by any contract or transaction in which he is involved because of his office, shall be punished by imprisonment of not less than four or more than six years and disqualification as established under subsections 1 and 2 of Article 36 of the Penal Code.

<sup>15</sup> The temporary closure will not exceed five years.

<sup>16</sup> Administrative Order 024-2001-CT-PJ, issued on January 31<sup>st</sup>, 2001.

<sup>17</sup> Defense of Free Competition Commission of Indecopi.

<sup>18</sup> MOTTA, M. (2004). *Competition Policy. Theory and Practice*. Cambridge University Press. Pp. 142-166.

- *Supply concentration.* The average number of bidders in public procurement processes is small, which according to economic theory facilitates collusion. In addition, given that the procurement processes are frequent, interaction between the bidders is constantly repeated over time. For example, it has been detected that many bidders are repeated in some processes under different names and items;<sup>19</sup>
- *Corruption.* As it is widely recognized, corruption could also facilitate collusion in public procurement, which is particularly worrying considering the high percentage of corruption in of the Peruvian GDP;
- *Legal limits (caps) on the price offered by bidders according to the State Procurement Law.* In the case of construction works, the State Procurement Law establishes that bids shall not be lower than 90% of the reference price nor exceed it by more than 10%. According to the CA, this legal provision ultimately reduces competition and could even facilitate collusion because all bidders know that nobody will place a bid above or below the limits established by the law. In fact, we can assume that a bidder that wishes to win the procurement process will respect the limitations specified in the law. However, if bidders want to collude, they can either agree to bid the lowest value allowed by the law (which is not a punishable conduct by the CA since the bids respect legal specifications) or some of them can agree to deliberately bid below or above the limits so they are disqualified from the tender, thereby enabling the remaining bidders to win the process.<sup>20</sup>

15. Certificates of independent bid determination are not employed in public procurement processes in Peru.

16. If firms have engaged in collusion, they can be sanctioned by the CA. Sanctions imposed by the CA may include fines as well as corrective measures leading to restore the competitive process and depend on whether the conduct is qualified as mild, severe or very severe.

17. In addition, according to Article 237 of the Regulations of the State Procurement Law, the State Procurement Court may impose additional sanctions to providers, participants, bidders and contractors if they participate in practices that restrict free competition, including temporary and permanent prohibition to participate in State procurement processes.<sup>21</sup> Furthermore, Article 105 of the Penal Code states that if a Criminal Judge verifies that a person or his organization has been used for committing or concealing a crime, he is obliged to impose a sanction to this entity, which may include the prohibition to conduct activities similar to those in which the crime was committed. Thus, assuming that a company was found liable in a process linked to the commission of a crime (not necessarily the corruption of officials) for events directly related to a public procurement or acquisition process, the Judge may prohibit that company from participating in such activities for a time period (not exceeding five years) or permanently.

18. Since Indecopi's inception in 1993, only four cases of bid rigging in public procurement have been effectively detected and sanctioned. None of these cases involved a case of corruption.

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<sup>19</sup> According to Santiago Antúnez de Mayolo, former Executive Chairman of the Supervisory Body of State Contracting – OSCE, interviewed on December 15<sup>th</sup>, 2009.

<sup>20</sup> More information about this factor can be found in the following reports of the Technical Secretariat of the Defense of Free Competition Commission of Indecopi: 002-2004-INDECOPI/ST-CLC, 036-2004-INDECOPI/ST-CLC, 037-2004-INDECOPI/ST-CLC and 012-2005-INDECOPI/ST-CLC.

<sup>21</sup> It should be mentioned that the Court will also impose this sanction when a person, within a period of four years, has received two or more sanctions which together add 36 or more months of temporary prohibition.

- Bid rigging in the procurement of oil barrels

The CA sanctioned two local producers of 55 gallon barrels (Rheem Peruana S.A and Envases Metálicos S.A.) for bid rigging in a procurement process organized by a State-owned refinery (Petroperu). Between the years 1995 and 1996, both Rheem Peruana S.A. and Envases Metálicos S.A. offered equal prices and almost equal quantities of barrels to Petroperu in three different procurement processes. The CA considered that the exact matching of prices and quantities was an important element to presume the existence of an agreement, especially taking into account that in the previous years the companies offered different prices and the total amount of barrels requested by Petroperu. Fines of 20 tax units were imposed on each firm (approximately, USD18 018).<sup>22</sup>

- Bid rigging in the tender for public works and the construction of a electricity distribution network

The CA sanctioned five construction firms (Villa Rica S.A. Contratistas Generales; E y R S.A. Contratistas Generales; J & J Ingenieros Asociados S.A.; JERRSA Contratistas Generales and Contratistas antares S.A.) for bid rigging in the public tender organized by a municipality for the renewal of a local road. In this case, the CA considered four events as evidence of the collusive agreement: (i) all firms presented a budget for the works with uniform amounts of direct costs and profits; (ii) similarity of details in the filling of the formats of the proposals, such as the letter fonts and punctuation marks; (iii) evidence that the tender documents were acquired by the bidders in consecutive order and on the same date, and (iv) some of the bidders rented their equipment and machinery from other bidders, which might be considered as an unusual behavior among supposed competitors. Fines of 0,5 tax units were imposed on each firm (approximately, USD 414)<sup>23</sup>

Similar events were considered by the CA in the analysis of a procurement process organized by Electro Sur Este (a state-owned electricity distribution company) for the construction of distribution network in the downtown area of Puerto Maldonado. In this case, three firms (Inti, Percy Enríquez Esquivel – Ingeniero Contratista and Quiroga Contratistas) were sanctioned for colluding in the above described process. Fines of 2 tax units were imposed on each firm (approximately, USD 1 662).<sup>24</sup>

- Bid rigging in the procurement of medicinal oxygen

The CA sanctioned three firms (Praxair Perú S.R.L., Aga S.A. and Messer Gases del Perú S.A.) that supplied medicinal oxygen to the Peruvian social health insurance company (EsSalud). The firms divided geographically their tenders in the procurement processes of the above mentioned input between the years 1999 and 2004. The analysis of the CA considered a series of events coincident in time, which occurred after a large price-level competition. The events did not appear to respond to a situation of effective competition and could only be explained as the product of a prior agreement between the defendant companies. The fines imposed to the firms

<sup>22</sup> Resolución 004-97-INDECOPI/CLC, February 21<sup>st</sup>, 1997.

<sup>23</sup> Resolución 003-99-INDECOPI/CLC, May 19<sup>th</sup>, 1999.

<sup>24</sup> Resolución 017-2000-INDECOPI/CLC, December 18<sup>th</sup>, 2000. Available in: <http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RELCLC2000/Res017-2000.pdf>

amounted to 3 826,82; 1 333,90 and 578,98 tax units, respectively (approximately, USD 4 887 669; 737 554 and 1 669 236, respectively).<sup>25</sup>

#### **4. Fighting collusion and corruption**

19. There has not been any prosecuted case involving both corruption and collusion in public procurement in Peru.

20. According to Peruvian legislation, leniency schemes may benefit individuals or firms who have committed criminal offenses using public resources or with the intervention of officials or public servants. In this sense, individuals or public officials who have engaged in bribery or corruption may obtain benefits such as the exemption from punishment or suspension of the execution of the penalty, among others.<sup>26</sup>

#### **5. Advocacy**

21. Within the framework of implementing the trade promotion agreement signed with the United States, a new State Procurement Law was issued in November 2008. This law aims at establishing standards designed to maximize value for taxpayer money used in the public procurement of goods, services and works, in a timely manner and with the required levels of prices and quality. Among the most important changes introduced by the new law, we have the following: (i) corporate purchasing and reverse auction, where appropriate, will be preferred; (ii) guidelines for the preparation and updating needs of the reference value are determined; (iii) special schemes for micro and small enterprises are maintained; (iv) infringements of suppliers, participating bidders and/or contractors that deserve sanctions are established, and (v) additional functions of OSCE are incorporated (such as the promotion of the reverse auction and the obligation to inform the National Control System about the cases in which rules of public procurement rules are violated, as long as there are reasonable causes to believe that State resources were mismanaged or a crime was committed).

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<sup>25</sup> Resolución 051-2010/CLC-INDECOPI. August 13<sup>th</sup>, 2010. Available in: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_051\\_2010\\_CLC/Res051-2010.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_051_2010_CLC/Res051-2010.pdf)

<sup>26</sup> See Subsection 1 of Article 1 of Law N° 27378, issued on 21 December 2000.