

SHIELDING PUBLIC PROCUREMENT IN MEXICO: A LONG WAY THROUGH COMPETITION



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BY FERNADO CARREÑO¹



¹ Partner of the Competition & Antitrust Practice and the Corporate and Mergers & Acquisitions, Joint Ventures Practices of Von Wobeser y Sierra.

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Fighting Supplier Collusion in Public Procurement: Some Proposals for Strengthening Competition Law Enforcement

By Alison Jones & William E. Kovacic



New Research on the Effectiveness of Bidding Rings: Implications for Competition Policies

By John M. Connor & Dan P. Werner



Bid Rigging in Public Procurement

By Robert Clark & Decio Coviello



Prohibitions on Contracting and the Future of Public Procurement Antitrust Enforcement in Spain

By Álvaro Iza & Luis Loras



The Department of Defense's Role in Merger Review

By David A. Higbee, Djordje Petkoski, Ben Gris & Mark G. Weiss



5 Years of Operation Car Wash: Revisiting Bid Rigging and Bribery Investigations

By Denis Guimarães & Diaulas Costa Ribeiro



Shielding Public Procurement in Mexico: A Long Way Through Competition

By Fernando Carreño



Antitrust Liability of Public Entities Acting as Awarding Powers in Public Procurement...The Hesitant Spanish Case

By Antonio Miño López



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I. INTRODUCTION

Ever since the concept of “Economic Welfare” appeared competition policies have focused on increasing the welfare of both consumers and undertakings.² Protecting the competitive process in markets has become the primary task for authorities in different jurisdictions around the world, seeking to obtain more accessible prices for consumers and increase economic efficiencies.

What, then, is the relationship between competition and public procurement? It has been shown that competition in public contracting processes is an essential tool for fighting corruption and ensuring their efficient development. The benefits of competition can be transferred to the process of public procurement, generating more competition among participants and much more aggressive proposals, with better prices, conditions and quality in the products.³ This translates into achievement of public objectives with a maximization of resources and guarantees the provision of goods and services of the highest possible quality.

For this reason, it is said that the design of each public bidding procedure should be oriented not only towards attracting the largest number of participants, but also generating intense competition among them, and reducing the spaces or incentives for the existence of collusive agreements and corruption. The existence of competition in a public bidding procedure depends mainly on two factors: (i) the design of the calls and procedures; and (ii) the establishment of institutional incentives for a correct application of the legislation.⁴

II. PUBLIC PROCUREMENT IN MEXICO

In Mexico, the Law of Acquisitions, Leases and Services of the Public Sector (“LAASSP”, its acronym in Spanish), establishes that public entities and agencies may choose among the following procedures for public procurement: (i) public bidding; (ii) invitation to at least three entities; and (iii) direct award. According to this legislation, as a general rule all public procurement should be carried out through the public bidding process. However, public entities have the opportunity to choose (under their own responsibility) any of the other two processes, so long as they fall into the exceptional cases provided by the Law.

² Massimo Motta, *Política de Competencia*, (Ciudad de México: Fondo de Cultura Económica, 2018), p 45-50.

³ Comisión Federal de Competencia Económica (2018). *Agenda de Competencia para un ejercicio íntegro en las Contrataciones Públicas*, p. 9 (<https://www.cofece.mx/wp-content/uploads/2018/07/CPC-ContratacionesPublicas.pdf>).

⁴ *Ibid.* 9.

Exceptions to the public bidding process, provided by law, give government dependencies or public entities a wide margin for deciding the kind of process to be implemented in public procurement. Although the authorities must explain and justify their decisions, in practice they can avoid implementation of a public bidding process so long as the project's operation or contract does not exceed the maximum amounts established for each of the awarding options in the annual Federal Budget of Expenditures.

On July 2018, the Mexican Antitrust Authority ("COFECE"), issued a formal document containing its analysis and recommendations for a better execution of public procurement processes in Mexico. COFECE found some inefficiencies in these processes, derived from (i) using alternate bidding methods through ambiguous or subjective justifications; (ii) restrict participation through unnecessary requirements; (iii) granting advantages to specific agents with certain technical specifications or other criteria; and (iv) facilitating coordination between bidders.⁵ According to data compiled by COFECE, in Mexico, in 2017, more than 228 thousand public contracts were awarded, with a combined value greater than \$585 billion pesos (US\$30bn). 78 percent of these contracts were granted through a direct award, 10 percent through an invitation to at least three people, and only 12 percent through public bidding.⁶

This implies that, of all contracts exceeding one million pesos, only a small proportion were awarded through public bidding mechanisms. This situation should be closely observed, since the greater the amount of a contract the more important it is that it be awarded through public bidding, as it is the only method that maximizes competition.

Why is competition so important in bidding processes? Well, the lack of competition in public procurement procedures is associated with an inefficient use of public resources since, without competition, these procedures could result in the acquisition of more expensive products or services, and of lower quality, than could be obtained in competition.⁷

Likewise, competition can help fight corruption, undue favoritism, or advantages for certain participants in a public procurement process. Lack of competition can have serious repercussions for public procurement, as it leads to the inefficient allocation of resources throughout society.⁸

According to the latest Global Corruption Barometer survey, corruption is a scourge that hurts ordinary people every day across the Americas, and when they speak out about it, far too often they face retaliation.⁹

Almost two thirds (62 percent) of people surveyed for the latest Global Corruption Barometer, People and Corruption: Latin America and the Caribbean, said that corruption had risen in the 12 months prior to their participation in the survey.¹⁰

More than half (53 percent) said their government is failing to address corruption. And one in three people (29 percent) who had used a public service in the last 12 months said they had to pay a bribe.¹¹

Bribery was found to be most common in Mexico and the Dominican Republic, where 51 percent and 46 percent of those surveyed said they'd had to pay a bribe to access public services. Police and politicians are perceived to be the most corrupt institutions in the region, with almost half of citizens saying that most or all the people in these institutions are corrupt. This demonstrates a worrying lack of trust in these vital public sector groups.¹²

⁵ *Ibid.* 9.

⁶ *Ibid.* 8.

⁷ *Ibid.* 8.

⁸ OCDE. (2010). *Roundtable on collusion and corruption in public procurement*. p. 205. OCDE. (<https://www.oecd.org/competition/cartels/46235884.pdf>).

⁹ Please see Global Corruption Barometer, People and Corruption: Latin America and the Caribbean.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

Corruption problems can be transferred to public procurement processes, preventing the efficient fulfillment of public objectives. For example, when a public servant favors certain participants, or gives them undue advantages through the use of privileged information in exchange for bribery, it generates extra-normal profits for the economic agent who is awarded the contract at artificially high prices. This in turn facilitates the payment of more bribes in exchange for continuing favors in future adjudication processes, generating a vicious cycle between corruption and lack of competition in which the public official can direct decisions to give victory to certain agents and facilitate collusive agreements violating the Federal Competition Act (“FCA”). Thus, corruption may in turn limit competition and exacerbate the lack thereof.¹³

That said, preventing corruption is not a task that can be completed through competition alone. Nonetheless, there are certain actions and strategies that can help protect public procurement processes and need to be considered by legislators and public entities.

III. SHIELD PUBLIC PROCUREMENT

So, the question is, in the presence of corruption problems and regulation that facilitates inefficiencies in public procurement, how can these processes be improved in order to efficiently achieve the state’s objectives?

As has been said before, the main reason for the existence of public procurement, from small purchases to big infrastructure projects, is to provide the State with the best consumables for the development of its constitutional and legal functions. They are a powerful tool for the achievement of public goals, so long as public funds are maximized and the provision of the best possible quality goods and public services is assured.¹⁴ The regulation of public procurement must therefore lay the foundations to achieve the best conditions for the State in its acquisition of goods and services and contracting for public works.

The lack of competition in public procurement procedures is associated with inefficient use of public funds, since it may result in the acquisition of pricey goods and services, technical specifications that are superfluous or excessive or, on the opposite end, of a lower quality than required, concealing defects and/or useless. These inefficiencies driven by the lack of competition in public biddings may occur because of:

- Using methods other than the bidding process, with ambiguous or subjective justifications.
- Restricting participation through unnecessary requirements.
- Granting advantages to specific agents with certain technical specification or other criteria.
- Facilitating the coordination of positions among bidders.¹⁵

Therefore, as said before, the existence of competition in public procurement would depend, mainly, on two factors: (i) the design of public calls and procedures, which depend on the regulatory framework; and (ii) the institutional incentives for the correct application of legislation.¹⁶

Public procurement regulation must lay the foundations to achieve the best conditions for the State in the acquisition of goods and services and contracting for public works. Competition in public procurement procedures is an ally for achieving the best possible procurement conditions.¹⁷

13 Comisión Federal de Competencia Económica (2018). *Agenda de Competencia para un ejercicio íntegro en las Contrataciones Públicas* (<https://www.cofece.mx/wp-content/uploads/2018/07/CPC-ContratacionesPublicas.pdf>).

14 *Ibid.* 7.

15 *Ibid.* 9.

16 *Ibid.* 9.

17 *Ibid.* 8.

In order to shield the public procurement in México, the design of the procedures should be orientated towards:

- Obtaining the highest possible participation, that is, avoid placing artificial limitations regarding the number of bidders through unnecessary technical requirements, using methods other than public biddings, or limiting participation to certain companies.
- Creating intense competition between participants, that is, favor tender offers with aggressive prices and avoid establishing rules that favor some of the participants; and
- Reducing spaces for the formation and sustenance of collusive agreements and corruption. Likewise, administrative efficiency must be prioritized in the implementation and follow up of public procurement procedures.¹⁸

IV. RECOMMENDATIONS TO PROTECT THE EFFICIENCIES ON PUBLIC PROCUREMENT

A. Obtain the Highest Possible Participation

To obtain the highest possible participation, it is recommended that public entities (i) make transparent and publicize market research for all procurements; (ii) improve the terms and conditions of the bidding rules; (iii) limit the exceptions to public biddings; and (iv) impede the negative effects of subcontracting and joint offers, through their correct identification.

Regarding the first recommendation, it should be considered that public procurement procedures are made up of different stages: planification, programing, and budgeting; the design of requirements and rules of participation; development of the contest; and the post-bidding stage, which includes formalization of the agreement, follow up, and in some cases, amendments and extensions. Aspects that favor or limit competition may exist in each of these stages.

Within the planification process, market research plays a crucial role. Through it, the organizing entity acquires the necessary information regarding market structure to make better decisions regarding the procedure to choose, the requirements and technical characteristics of the goods and services to be acquired, as well as estimated prices based on the information gathered, among other relevant data. Therefore, it is important that market investigations are carried out in an comprehensive, reliable and solid manner.¹⁹

In that regard it is important to bear in mind that certain companies may manipulate budgets presented during the market research stage in order to achieve subsequent awards on higher prices than those that would prevail given a competitive environment. Here, companies may collude to fix, elevate, arrange, or manipulate the prices they offer at the market research stage in order to artificially fix a high maximum reference price. This could even result in a reduction of participation due to disqualification of certain participants for offering “abnormally low prices.” In addition, they may coordinate to make it more difficult for a larger number of companies to participate through the imposition of technical barriers or other restrictions, and this way guarantee the allocation of contracts to specific agents. The aforementioned can be made that much easier by acts of corruption.²⁰

As for the second recommendation, the design of the procedures should, at least, consider the following: (i) establishing only those requirements that are strictly necessary and that are transparent, objective and nondiscriminatory; (ii) spreading promptly and within a reasonable time period the relevant information in order for participants to prepare their proposals, but avoiding the release of information that may facilitate the formation of collusive agreements; (iii) using objective criteria to qualify the technical and economic solvency of the proposal and to allocate the agreements. Overall, it is essential to reduce the scope of discretion and uncertainty through the procedure so that the economic agents can elaborate their proposals based on the characteristics of the goods/services they offer, and not strategically anticipating the possible behavior of the public officer in charge of the bidding.²¹

¹⁸ *Ibid.* 7.

¹⁹ *Ibid.* 15.

²⁰ *Ibid.* 15.

²¹ *Ibid.* 16.

As for the third recommendation, it must be considered that there are alternative methods to public bidding for the allocation of public contracts: invitation to at least three agents, and direct allocation. The regulation establishes that these methods may only be used in exceptional cases and scenarios provided by the law. Likewise, the legislation establishes limits regarding the amounts involved in contracts that may be allocated with a procedure other than public bidding.²²

The use of these exceptions may answer to valid reasons, like the purchase of goods with patent protection, or an administrative efficiency criterion regarding minor purchases. Nonetheless, given the generic nature of these scenarios, an excessive use of the exceptions may arise, making it necessary to restrain their use as much as possible. A clear example of wrong use of such exceptions was the direct purchase of boots for the uniforms of traffic police officers, claiming it as an issue of national security.²³

Finally, regarding the fourth recommendation, it would be beneficial to implement the following: (i) require bidders to reveal in advance who they plan to subcontract, for what purposes, and why; (ii) prevent the subcontracting of persons or companies that have participated in the bid through which the contract was awarded; and (iii) when the presentation of joint offers is permitted, not allow participation by the same bidder individually and as part of a joint offer in the same contracting procedure.²⁴

Implementation of these recommendations will allow for the largest possible concurrence, since they will contribute towards avoiding artificial limitations on the number of bidders through unnecessary technical requirements, alternatives to public biddings, or having participation limited to certain selected companies.

B. Create Intense Competition Between Participants

In order to create intense competition between participants, it is recommended to (i) create a virtual market for small purchases of homogenous goods for government agencies; and (ii) prohibit simultaneous participation by entities of the same group.

Virtual markets for public purchases are electronic platforms that allow for interaction between suppliers and public officials responsible for contracting in a dynamic and competitive environment. The use of a virtual market promotes competition since, among other things, it facilitates the participation of small and mid-sized companies in public tenders.²⁵

In virtual markets, the public officials introduce purchase requests specifying their needs, while the suppliers (previously authorized) publish their products in an electronic catalog (including quantities available, unit price, and delivery times, among other information). When a particular good or service satisfies the needs of the authority, the official determines the quantity and method of delivery. Subsequently, the supplier receives a purchase order through the virtual market's webpage that specifies the quantities to be supplied. If it has the capacity, the purchase becomes official. The virtual market focuses on purchases of relatively small amounts and homogenous goods. In practice, a maximum amount is often established above which it is not possible to use this platform (and therefore the traditional methods must be used). As for the type of goods and services, it is often the least complex (more standardized) that incorporated into the virtual market.

It is similarly important to ban simultaneous participation by entities belonging to the same economic group, since presentation of multiple offers by one interest group may have anticompetitive effects when they do not allow free competition in public biddings, unfairly displace competitors, or allow the renegotiation of bids in favor of companies within the same economic interest group.²⁶

²² *Ibid.* 23.

²³ *Ibid.* 24.

²⁴ *Ibid.* 47.

²⁵ *Ibid.* 47.

²⁶ *Ibid.* 20.

First, it may limit the participation of other agents when, in a market study for example, it is considered (artificially) that enough participants exist, but they are within a same economic interest group.²⁷ Second, an economic interest group may displace competitors in public procurement procedures that allow simultaneous supply. For instance, if the organizing entity decides to carry on a procedure that considers allocating 80 percent of the contract to the first-place winner and 20 percent to the second place, the economic interest group may establish two different proposals through its affiliates and obtain, jointly, 100 percent of the contract. The above may have the intention or effect of displacing competitors from the market and reduce competition in the long term.²⁸

The creation of a virtual market for small purchases and a prohibition on simultaneous participation by entities belonging to the same group would favor tender offers with aggressive pricing and avoid establishing rules that favor only some of the participants, ensuring intense competition between participants.

C. Reduce Spaces for the Formation and Sustenance of Collusive Agreements and Corruption

Finally, to reduce the spaces available for collusive agreements and corruption to grow, it is necessary to (i) require the participation of the competition authority in relevant public biddings; and (ii) enforce the prohibition on economic agents sanctioned for collusion from participating in subsequent public contests.

In this regard, Competition Authorities would be able to: (i) identify technical requirements that could reduce the number of participants and favor certain entities within the bidding rules; (ii) suggest competition principles within the bidding rules; (iii) in applicable cases, provide a competition assessment on the bidders and corresponding markets. A monetary threshold could be considered in order to determine which procedures the authority should participate in.²⁹

On the other hand, regarding the ban on economic agents sanctioned for collusion from participating in a subsequent public bid, the Law on Administrative Liabilities in Mexico (by its acronym in Spanish “LGRA”) contemplates such a prohibition on participation for collusion, when the private parties collude for the purpose of: (i) obtaining any improper benefit or advantage in public contracting; or (ii) cause damages to Public Finances or the wealth of Public Entities.³⁰

In this respect, it is also necessary to fully enforce the prohibition on economic agents sanctioned for collusion from participating in subsequent public bids, established in the LGRA for economic agents that have been sanctioned due to collusion by the COFECE under Article 53, Section IV, of the FCA, with exceptions available for agents that have been granted immunity and a reduction of sanctions under the Leniency Program contemplated in the LFCE. Additionally, criteria for exceptions may be considered, and possibly regulated, when such a prohibition could cause a lack of supply.³¹

These measures will contribute to prioritizing administrative efficiency towards the implementation and follow up of public procurement procedures, reducing opportunities for collusive agreements and corruption.

²⁷ *Ibid.* 30.

²⁸ *Ibid.* 30.

²⁹ *Ibid.* 38.

³⁰ *Ibid.* 39.

³¹ *Ibid.* 49.

V. CONCLUSIONS

The processes of public procurement in Mexico are affected by the extent of discretion that the regulation grants to public agencies and entities. This broad discretion decreases the efficiency of these processes and hinders the attainment of public objectives such as the maximization of resources and the assured provision of goods and services of the highest possible quality.

One way to combat this situation would be to seek and ensure competition in these processes. There being competition will depend on two main factors: (i) the design of the calls and procedures; and (ii) the institutional incentives for a correct application of regulations.

Therefore, we make the following recommendations: (i) obtain the highest possible participation; (ii) create intense competition between participants; and (iii) reduce spaces for the formation and sustenance of collusive agreements and corruption.

Competition is of great importance in public procurement processes, because when a bid is designed with competition in mind overpricing is restricted, along with the space for favoritism and undue influence, impeding the formation of collusive agreements that harm the public budget and the welfare of the entire society.³² Thus, competition leads to welfare through the maximization of public resources.

³² *Ibid.* 11.



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