
An economic analysis of Debarment

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Simon Kuznets Conference
25 April 2024
Kharkiv

Debarment Principle

Is debarment of dishonest suppliers a good strategy for protecting markets against corruption and collusion?

- Suppliers are disqualified from taking part in tenders if they cannot be trusted due to their past involvement in certain forms of crime, corruption included.
- US Congress enacted a law in 1884 requiring the executive to award contracts to the lowest responsible bidder. Active debarment was introduced by the Comptroller General in 1929.
- Since the mid-1990s, most countries and international agencies have reformed their procurement rules to include it (WB, US, Canada, EU, OECD, Japan, China, Nigeria, India, Indonesia, Bangladesh, Liberia, Mongolia, Pakistan, the Philippines, Vietnam, etc)

Background

High expectations in policy world

- *"suspension or debarment from public contracts has proven to be an effective tool in the fight against corruption"* (UNODC 2013: 25)
- *"The World Bank's sanctions process is critical to eradicate fraud, corruption and collusion from the projects it finances"* (Hugeuette Labelle, then Chair of Transparency International in press release, 26 June 2014)

Scholarly literature? Economics...?

- The literature on debarment is written by legal scholars and focuses on the act of debarring, on due process, and on the legal status of those debarred.
- The debarment instrument has been enacted without the support of economic analysis.

Our research: conduct an economic analysis of debarment

- Law papers on debarment (Hjelmeng and Søreide, 2015; Søreide, Gröning and Wandall, 2016).
- Economic analysis of procurement in IO (Auriol 2006)

➔ To what extent would debarment deter corruption and collusion?

Analytic framework

IO-approach. Market size/public demand varies across periods. Non-homogenous firms. Endogenous N .

Model describing procurement story:

- government wants to procure Q
- N firms can serve the market at cost qc_i^t where c_i^t are IID $U_{[0,1]}$
- Cost of of organizing competitive bidding K varies in $\{\underline{K}, K\}$
- $\delta < 1$ is the discount factor

Corruption: the public purchaser direct a contract to a certain supplier using **sole sourcing** instead of using **competitive bidding** in exchange for a bribe

In period t competitive bidding is optimal iff

$$Q \frac{N-1}{N+1} \geq K$$

Result corruption

*Let $1 - p \in [0, 1]$ be the probability of corruption detection.
Debarment will deter corruption if and only if*

$$\delta \geq \frac{N(N+1) - 2}{N(N+1) - 2p}$$

Debarment will deter corruption if the firms value future sales enough (δ is large enough), if the number of firms N is not too large and if the probability of corruption detection $1-p$ is high enough.

It will fail to curb corporate crime otherwise.

Debarment in the long run

If corruption occurs in equilibrium: in each period a firm is debarred with probability $1 - p > 0$ and the number of firms qualified to compete is reduced.

Debarment has an anti-competitive effect: cartel is a new threat.

Result collusion

Debarment will deter collusion if and only if the probability of cartel detection d is so that: $d > d'$

If the firms are patient then d' is negative and collusion never occurs in equilibrium.

If the firms are not patient enough then d' is strictly positive and the probability of detection must be large enough to deter collusion.

Drawback of debarment: concentration increases

If the probability of detection is positive but lower than the threshold d' then debarment entails a competitive cost without generating any benefit.

If all the firms involved in the collusive conspiracy are debarred upon discovery the principal ends up with nobody to serve its markets!

Debarment: useful or window- dressing?

In practice debarment is not often used

- OECD (2014): only 2 debarments out of 427 foreign bribery cases.
- TI (2014): European Union, which spends EUR 2.5 trillion a year on goods and services, debarred only six companies for fraud and corruption.

Debarment is not a comprehensive anticorruption solution, but it is a relevant tool for international organizations: It helps disciplining international firms.

Debarment seems a poor instrument to fight collusion. It weakens leniency programs implemented by anti-trust authorities => There is a need for coordination and harmonization of procedures and sanctions.

To go
further...

- “An economic analysis of debarment”, Emmanuelle Auriol and Tina Søreide, International Review of Law and Economics, Volume 50, 2017, Pages 36-49, <https://doi.org/10.1016/j.irle.2017.04.004>.
- “Deterring corruption and cartels: In search of a coherent approach”, Emmanuelle Auriol, Erling Hjelmeng and Tina Søreide, Law & Economics I Concurrences N° 1-2017 <https://www.concurrences.com/fr/review/issues/no-1-2017/droit-et-economie/dissuader-la-corruption-et-les-cartels-a-la-recherche-d-une-approche-coherente>
- “Corporate criminals in a market context: enforcement and optimal sanctions ”, Emmanuelle Auriol, Erling Hjelmeng and Tina Søreide, 2022, working paper.



Thank you!

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