Corruption in bidding processes as a determining factor in cartel formation: an economic approach to the legal system in the government procurement market*

A corrupção em processos licitatórios como fator determinante da formação de cartéis: uma abordagem econômica do ordenamento jurídico no mercado de compras governamentais

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ABSTRACT

The aim of this paper is to discuss the practice of fraud and corruption perpetrated by companies and public agents in the government procurement market and formation of cartels, in order to demonstrate the need for implementation of ex-ant controls and risk management based on a new regulatory framework for bids. From the comparative literature on the formation of cartels, it is intended to identify the explanatory mechanisms of the spurious relationships between public agents and private companies, conceived under the aegis of law number 8,666/93, which led to the practice of fraud and corruption in public contracts. Finally, we present the structuring of lines of defense forming a fraud and corruption mitigation system, incorporated in the new regulatory framework for public procurement. The methodology applied is inductive, considering that the analysis seeks a conclusion from the evidence of concrete cases.

KEYWORDS

economic analysis of law — cartel — government procurement — corruption — compliance

RESUMO

Este artigo tem por objetivo discutir a prática de fraudes e corrupção perpetradas por empresas e agentes públicos no mercado de compras governamentais e a formação de cartéis, com vistas a demonstrar a necessidade de implementação de controles ex ante e gestão de riscos fundamentada na nova lei de licitações. A partir da literatura sobre a formação de cartéis, pretende-se identificar os mecanismos que explicam as relações espúrias havidas entre os agentes públicos e empresas privadas, concebidas sob a égide da Lei nº 8.666/1993, que levaram à prática de fraudes e corrupção nas contratações públicas. Por fim, apresentamos a estruturação de linhas de defesa, com um sistema de mitigação de fraudes e corrupção, incorporado no novo marco regulatório das licitações. A metodologia aplicada é indutiva, tendo em vista que a análise busca uma conclusão a partir das evidências de casos concretos.

PALAVRAS-CHAVE

análise econômica do direito — cartel — compras governamentais — corrupção — compliance

Introduction

Before we begin our analysis of the legal institution under which cartels flourish in Brazil, causing untold losses, it is important to highlight that the phenomenon of cartelization is not exclusive to this country. It is a market failure derived from the capitalist system itself. Thus, it is necessary to outline in the light of economic law the structures that control certain market niches with respect to governmental acquisition of goods and services.

In this context, normative analysis of law is no longer sufficient to explain this phenomenon. A more accurate study of cartels in the capitalist system using economic tools is required, before discussing the legal system of public procurement. An understanding of the *modus operandi* of cartels in public tenders in Brazil is a *sine qua non* for explaining the poor results of police operations and even by law enforcement agencies, among which the Public Prosecutor's Office and administrative courts should be highlighted.

It is from this knowledge of cartelization as an economic phenomenon that we construct a normative analysis of the instruments that govern public procurement, to comprehend and combat first and second-order corruption, which leads to the consolidation and proliferation of cartels under the aegis of the obsolete, but still in vigor, regulatory instrument — Law No. 8,666/1993.[1]

Despite the valiant, rigorous work of police operations in combating corruption and economic crime, it is clear that only new compliance tools will make it possible to greatly reduce cartel activities in the government procurement market.

Lastly, we demonstrate how the new national regulatory framework for bidding and contracts includes in the national legal system new tools to mitigate this market failure that allows the proliferation of cartels in the government procurement sector.

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[1] BRASIL. *Lei nº 14.133, de 1º de abril de 2021*. Lei de Licitações e Contratos Administrativos. Diário Oficial [da] República Federativa do Brasil, Brasília, DF, 01 abr. 2021. Available at: https://www.in.gov.br/en/web/dou/-/lei-n-14.133-de-1-de-abril-de-2021-311876884. Accessed on: 10 jan. 2022.

1. The constitutional principle of free competition and the market failures of the capitalist system

According to the classical theory of price equilibrium, Adam Smith's invisible hand, exchanges (negotiations between suppliers and demanders) take place in a market that tends towards price equilibrium or market-clearing. In this ideal commercial model, customers carry out their acquisition of goods or services in the most efficient way possible, i.e., allocate financial resources aimed at the lowest possible price. For didactic purposes, it should be noted that in this market, of public purchases, the government in all its spheres (Union, states and municipalities) functions as a consumer, and not as a regulatory organ, and, thus, on the demand side, subject to market rules, including the most significant: free competition — essential to achieving market equilibrium in the classical economic model.

Emery Kay Hunt, in History of Economic Thought, exemplifies the model developed by Adam Smith in the following terms:

> Thus, the natural price was an equilibrium price determined by production costs, established in the market by the forces of supply and demand; market price fluctuations would tend to stay around the natural price. According to Smith's price theory, the quantity defendant would allocate capital across the various industries, thus determining the composition or relative quantities of the different goods produced. However, the production cost would determine, by itself, the equilibrium price or natural price that would tend to prevail in any market.[2]

Professors Robert Pindyck and Daniel Rubinfeld agree with this understanding in their classic microeconomics manual:

> This is the most direct way of illustrating the famous invisible hand of Adam Smith, as, according to it, the economy will automatically allocate resources to achieve Pareto efficiency without the need for regulatory control. It is action independent of consumers and producers,

[2] HUNT, E. K. *História do pensamento econômico*. 2. ed. [S.l.]: Campus, 2005. p. 93.

> who accept prices as given, which allows markets to function in an economically efficient manner.[3]

Therefore, even though the State has Regulatory Power, this same State favors the principle of free competition in the 1988 Constitution in article 170, item IV, submitting to it with all its flaws and possibilities (world of being).

In this sense, as the renowned professor Eros Grau observes, the Brazilian state, through the 1988 Constitution, made a political choice to adopt the capitalist system of free competition, elevating it to the condition of fundamental principle of the national economic order:

> Free competition is made a principle by the 1988 constitution, contemplated in art. 170, IV, comprising, among others, what has been referred to as "principles of order". This is, as already noted, the principle of constitutional imposition.[4]

In a way, by adopting free competition as a guiding constitutional principle of the economic order, the State, in the condition of plaintiff or consumer, submits to the model of equilibrium — marketing clearing — structured by classical economists and, consequently, the market failures intrinsic to this model that affect the general price balance. In this regard, we return to the understanding of Professor Eros Grau to demonstrate that the constituent recognizes market failure — imperfect competition — resulting from economic power, while understanding it does not control it nor make it disappear:

> § 4 of art. 173 refers to 'abuse of economic power'. It is worth noting: the 1988 constitution recognizes this. Not that it should not, although the contrary circumstance would not suggest the power to banish it from reality. However, having recognized it, the principled consecration of free competition sounds strange. Not occurring, in the presence of the consecrated principle, the aforementioned § 4 would provide, 'The law will repress abuses arising from the exercise of economic activity…'.

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[3] PINDYCK, Robert S.; RUBINFELD, Daniel L. *Microeconomia*. Tradução Daniel Vieira. 8. ed. São Paulo: Pearson Education do Brasil, 2013. p. 602.

[4] GRAU, Eros Roberto. *A ordem econômica na constituição de 1988*: interpretação e crítica. 8. ed. São Paulo: Malheiros, 2003. p. 208.

> Notwithstanding — I repeat — it would be entirely in vain: economic power would not cease to manifest itself in the real world — the world of being — in armfuls.[5]

So that the legal system does not succumb to economic praxis, there remains, in the last analysis, an understanding of this market phenomenon in the light of law and economics. To this end, we borrow from economists the concept of cartel as an economic phenomenon, demonstrating how this behavior can spread across any and all markets, at the expense of the Law, reaching and controlling, including and mainly, the lucrative market of government purchases.

The government procurement sector is a market and must be studied as such, according to the economic law tools available to legal operators. In this regard, Professor Caliendo teaches us that, in the real world, competitive markets present flaws not covered by the initial equilibrium model of classical economics. In the case of cartelization, there is a market failure resulting from imperfect competition, which occurs when a given economic agent holds so much power that it prevents other parties benefitting from the exchange system. Such a situation occurs, for example, in cases of monopoly or oligopoly where there is manipulation of prices so that there is a transfer of resources from consumers to monopolists.

Imperfect Competition is when a given economic agent holds so much power it prevents other economic agents from benefiting from the exchange. Such situation occurs, for example, in cases of monopoly or oligopoly where there is manipulation of prices so that there is a transfer of resources from consumers to monopolists.[6]

The economists Pindyck and Rubinfeld, in their classic work *Microeconomics*, establish two basic conditions for the success of a cartel: the first is that those involved in the business are capable of making and complying with agreements regarding prices and quantities to be offered in the market niche desired; the second is the monopoly power exercised by the group of suppliers.

In a cartel, producers explicitly agree to act together in determining prices and production levels. Not all producers in a sector need to be part of the cartel and most cartels involve only a subset of producers. But, if a large enough number of producers choose to adhere to the terms of the cartel agreement and

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[5] Ibid., p. 208.

[6] CALIENDO, Paulo. *Direito tributário e análise econômica*. Rio de Janeiro: Elsevier Brasil, 2009. p. 473.

market demand is sufficiently inelastic, the cartel may be able to raise prices well above competitive levels.[7]

The following maintain the necessary conditions for the success of the cartel:

> CONDITIONS FOR CARTEL SUCCESS: There are two conditions for a cartel to be successful. The first is that a stable organization will be formed, whose members are able to make agreements regarding prices and production levels, complying with the terms of the agreement made. The second condition is the potential to impose monopoly power. The potential of monopoly power can be considered the most important condition for achieving success; if there are potential gains arising from cooperation, cartel members will have greater incentive to solve organizational problems.[8]

It is necessary to add to the structuring of cartels demonstrated by Pindyck and Rubinfeld a third fundamental condition for the success of governmental purchase cartels: corruption of officials responsible for carrying out and managing tenders, enabling and "legalizing" perpetrated fraud in collusion with cartelized companies.

The practice of corruption appears preponderant in the success of cartels in the government procurement market. This is in turn typified in the Brazilian legal system: (a) active corruption in companies that entice public agents to somehow become the winner of the bid and/or prevent other companies from participating through supposedly legal means; and (b) passive corruption, where these same officials are subject to financial advantages due to their function, to facilitate the cartel to the detriment of free competition.

The Brazilian Penal Code describes corruption as follows: requesting or receiving, for oneself or someone else, directly or indirectly, even external to the role or before assuming it, but by reason of it, undue advantage, or accepting a promise of such an advantage; and offer or promise of undue advantage to a public official, determining performance, omission or delay of an act of office. However, the question that arises is: if corruption, which is the main pillar of support for cartels in the public procurement market, is described in the criminal code and subject to strong penalties, and is, to a certain extent, easy to identify,

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7 Robert S. Pindyck e Daniel L. Rubinfeld, *Microeconomia*, op. cit., p. 473.
8 Ibid., p. 474.

why is it so difficult to fight it? One of the answers to this intriguing question lies in the exceptional research developed by Professor Lino, published in his fascinating article *Fighting or supporting corruption? The role of public sector audit organizations in Brazil*, in which he identifies an evolution in cartel power in corrupting public agents. For the author, the corruption occurs at two levels: (a) first-order corruption, occurring directly vis-a-vis public officials responsible for purchasing goods and services; and (b) second-order corruption, the most serious, involving high-ranking public officials of the Courts of Accounts, responsible for deciding on the legality of agreements between public authorities and the private sector, perpetrating a selective justice that validates and gives the necessary "legality" to the illicit acts of cartels in collusion with public officials.

As André Feliciano Lino highlights, there is a second level of corruption in Brazil which has led administrative and judicial courts to practice selective justice to the detriment of society and benefit of cartelized companies:

> An in-depth knowledge of corruption processes and what facilitates them is made more difficult by the hidden nature of the phenomenon. Furthermore, the literature has often focused on first-order corruption, i.e., when actors abuse their power to break or reinterpret rules and norms looking for private gains (Zyglidopoulos, 2016). Much less is known about actors changing the rules and norms for their private gain – characterized as second-order corruption (Zyglidopoulos et al., 2017; Cooper, Dacin & Palmer, 2013). […] The Brazilian Courts of Accounts appear to be an interesting setting for the observation of both first-and second-order corruption as Magistrates have been shown to be frequently involved in bribery and kickbacks, while also having the power to interpret, formulate, and change intraorganizational rules and norms.[9]

From another angle, professor Marcos Nóbrega, in an article published in *Revista Brasileira de Direito Público*, states that the problem lies in the modeling of tenders, which is unable to guarantee more efficient bidding procedures. For him, there is an information asymmetry between the government, as the plaintiff,

[9] LINO, André Feliciano et al. *Fighting or supporting corruption? The role of public sector audit organizations in Brazil*, Critical Perspectives on Accounting, v. 83, 2022, https://doi.org/10.1016/j.cpa.2021.102384.

and potential companies, suppliers of goods and services. Such asymmetry of information causes the separation of more competitive companies, which could balance the price and reduce the influence of cartels in the government procurement market. The author also states that the Judiciary Power and administrative courts, by observing only legal rules, successively neglect this market failure — information asymmetry —, validated according to the legal permissiveness established by the Brazilian tender regulations and contracts.

> It is striking how the issue of information (or lack thereof) is neglected by Brazilian law, whether by legislation or (what seems more serious) by its enforcers. The Judiciary in general, and the Audit Courts in particular, live in an obsolete world. They internalize legal rules as if we operated in the idealized environment of the neoclassical scholars of the 19th century. A world where we would have perfect data, absolute rationality, complete contracts and absence of costs of transaction.[10]

In line with Nóbrega, Caliendo pointed to this market distortion, in that the market would never be able to efficiently allocate the goods demanded (market failure); otherwise, we see as follows:

> Asymmetric information (informational asymmetry) or information problems arising from the nature of certain operations or goods. This situation occurs especially when a given official holds private information that is not fully available to other officials or consumers. Thus, for example, in the case of hiring a mechanic or stockbroker, the consumer does not have sufficient information to determine whether the contract is being fulfilled satisfactorily. Other categories that share these characteristics are public goods; common resources and scarce goods.[11]

It is evident that the government procurement market, when subject to the principle of free competition, is subject to market failures intrinsic to the capitalist system of production and commerce. In the following sections, then, we will demonstrate the *modus operandi* of cartels in bidding processes and how

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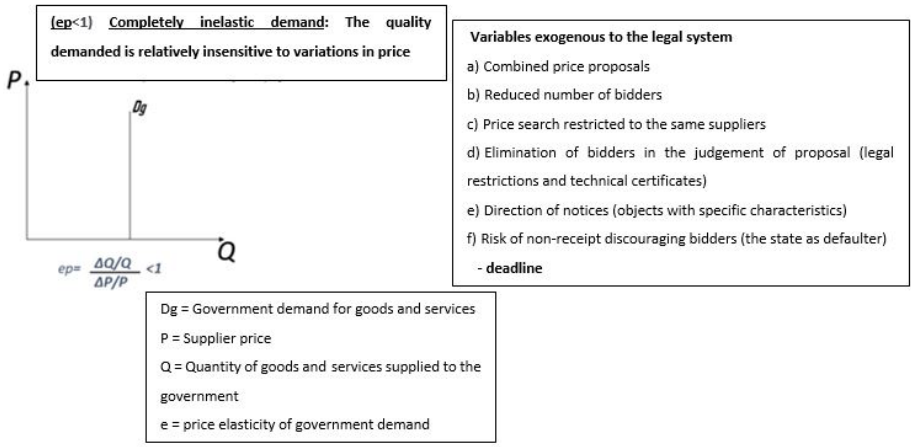
[10] NÓBREGA, Marcos. *Direito e Economia da Infraestrutura*. Belo Horizonte: Ed. Fórum, 2019. p. 2.
[11] Paulo Caliendo, *Direito tributário e análise econômica*, op. cit., p. 76.

companies and government agents act in collusion to perpetrate fraud that guarantees the "legality" of hiring at the expense of public procurement probity.

1.1 Game theory and the formation of cartels in the government procurement market

To clarify the behavior of companies in the government procurement market and formation of cartels, a didactic effort is necessary based on demonstration of the concept of "price elasticity of demand" which will directly influence the proposition presented in graph 1:

Graph 1
Price elasticity of demand in the government procurement market



Source: Graph adapted by the authors based on the economic model of demand elasticity.

The graph demonstrates that government demand for goods and services is completely inelastic, since it will continue to purchase a fixed quantity of goods and services regardless of the price presented by the bidding companies. This established corollary of economic science, game theory, can be applied to demonstrate that companies, when responding to a call from the government to provide some good or service, mainly act collaboratively to avoid fierce competition, eliminating the effects of the principle of competition enshrined in the law of tenders and contracts.

In a bidding process with only two or three companies for a given object (common case in *auctions*), initially company A will raise its price, allowing company B to win the bid, which may initially seem unreasonable, since the

objective of any company should be success, but as companies participate in different tenders offering the same modalities, company B in a second round will raise its prices allowing company A to win. This interaction leads to the market distortion called cartelization, purging other competitors, i.e., those without large competitive margins and gains in scale, or who are unable to operate in the medium term with negative prices or prices below the operating cost line. In this case, the cooperative game is harmful to the plaintiff, since acquisition prices remain above average market prices.

In the real world this game is widely known as "hedging proposals", frequently used to validate the competition rule and frame the purchasing process according to requirements set out in article 45, item I, of the law on bidding and contracts, or vis-a-vis the auction modality, in article 4, item X, in which validation is repeated regardless of the bidding modality applied in acquisitions. In fact, in the same light, the old regulation of public contracting did not encompass, nor organize market relations, according to that which was proposed. Take Laws no. 8,666/93[12] and 10,520/2002[13], which, up to that point, regulated and structured the contest.

Note that the new regulatory framework for bidding (Law no. 14,133/2021),[14] despite bringing the innovation of the "highest discount" criterion, maintains the same game rules based on bids and the lowest price to declare the winner.

All bidders should be aware of the rules and criteria established in the bidding notice and are able to exchange information with each other before the contest starts (the public tender), which leads them to make cooperative moves (previously arranging bids or adjusting the values of price proposals) to determine who will win the contract. They may even distribute, through bargaining or cheating,[15] the results in a hegemonic way, determining which company will be awarded a portion of the government demand, as Luciano Benetti Timm affirms:

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[12] BRASIL. *Lei nº 8.666, de 21 de junho de 1993.* Regulamenta o art. 37, inciso XXI, da Constituição Federal. Diário Oficial [da] República Federativa do Brasil, Brasília, DF, 22 jun. 1993. Available at: http://www.planalto.gov.br/ccivil_03/leis/l8666cons.htm. Accessed on: 10 Jan. 2022.

[13] BRASIL. *Lei nº 10.520, de 17 de julho de 2002.* Institui modalidade de licitação denominada pregão, para aquisição de bens e serviços comuns. Diário Oficial [da] República Federativa do Brasil, Brasília, DF, 17 jul. 2002. Available at: http://www.planalto.gov.br/ccivil_03/leis/2002/l10520.htm. Accessed on: 10 Jan. 2022.

[14] BRASIL, Lei nº 14.133, de 1º de abril de 2021, Lei de Licitações e Contratos Administrativos, op. cit.

[15] Common practice among cartelized companies that participate in bidding processes is to pay a a certain "withdrawal fee" to other participants in the contest so that they give up bidding or do not even participate in the tender.

> According to bargaining theory, in a cooperative game, such as a private agreement, the Parties will cooperate in an attempt to direct the goods or service to the party that values it most. This will occur as long as the parties agree on the positive balance divided between them. In short-term business relationships, parties tend not to consider the various consequences of their attitudes (especially when there are no informal penalties, such as damage to reputation or registry on the debtors list). As the other party is able to predict this dominant (flawed) strategy, it can prevent the deal from taking place.[16]

From Professor Luciano Timm's study it is clear that there is a cooperative game in the government procurement markets that occurs when participants trade binding contracts with mandatory compliance, which allows them to plan joint strategies to defraud the system established by the bidding law.

Thus, it is clear that government procurement regulations are still based on the outdated equilibrium price model, in which companies would tend towards a "healthy" market dispute in which the winner was the one who offered the goods or service to the government at the lowest possible price, thus achieving a price equilibrium between the bidders and the public administration now subject to rules of the outdated equilibrium price model or market-clearing.

2. The fragility of the Brazilian public procurement instrument and the institutionalization of fraud and corruption practices

The guiding principles of public procurement in Brazil set out in article 3 of Law no. 8,666 of 1993[17] have always been restricted to the scope of the basic principles of legality, impersonality, morality, equality, and the results desired and achieved in the bidding processes were tied to the search for customer service according to the lowest price criterion, providing fertile ground for fraud and corruption of all kinds, supported by exploitation of existing weaknesses in that legal rule.

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[16] TIMM, Luciano Benetti. *Direito e economia no Brasil*. São Paulo: Editora Atlas, 2012. p. 24.

[17] BRASIL. Lei nº 8.666, de 21 de junho de 1993. Regulamenta o art. 37, inciso XXI, da Constituição Federal. op. cit.

Understanding the statute, which governed government purchases until April 1, 2023, we observe the ease with which cartels manipulate bids, removing other bidders vis-a-vis "legality", since the principle of transparency — one of the key indicators — could be realized only by announcing the draft notice in the Official Gazette (almost never read) or publication in a mass circulation newspaper, the exact definition of which is still largely unknown today. On the other hand, the principles of morality and impersonality, as they are difficult to interpret, when used as support in prosecutions, are easily overturned by the defense of the accused.

Finally, the principle of legality, which in real cases entails the requirement of certificates, attestations of technical capacity and compliance with notice deadlines, is perhaps most used by cartels and corrupt government officials to "legalize" the practice of fraud in governmental incidents, enabling corruption of the first and second order.[18] Lack of fundamental principles for disciplining the economic order, the statute of administrative contracts that regulates the government purchasing market directs public officials responsible for the acquisition of goods and services, and even those at the highest legal level responsible for deciding on the probity of acts and facts, the application of legal norms through mere discretion and almost always benefiting cartels.

It is also important to highlight the criterion of the lowest price, contained in the text of article 65 of the bidding law, which has long been used as an instrument to bolster the practices of cartels in government purchases, since cartelized companies use these regulations to keep out their competitors; what in the open market would constitute the practice of dumping, in the government procurement market is effectively "legalized" by the administration. The reader might imagine that cartels could not operate forever with prices below the cost line, but, in practice, a combination of minimum prices guarantee the contract, followed by an increase in contractual value by the inclusion of value additive terms permitted by law, which allows increases of up to 50% on the initially agreed amounts.

This criterion — the lowest price — is a topic that needs further attention, consolidated, as it is, in the new law on bidding and contracts; however, we should emphasize that the principle of efficiency enshrined in article 37 of

[18] First order corruption occurs when public agents responsible for government procurement manipulate the results in favor of cartelized companies. Second order corruption occurs when high-ranking members of the Courts, administrative or judicial, issue decisions that validate the illicit acts and fraud committed in the first place.

the Constitution has over time been neglected by public administration in favor of the lower criterion for government purchases, given the occurrence of successive additive terms in the execution of contracts, not in line with the principle of efficiency.

Until the promulgation of Law no. 14,133/2021,[19] there was no national legal system or general norm that took into account the eminent economic law on the matter, leaving legal actors to operate within the scope of criminal law using the fragile principles of administrative law — legality, impersonality, morality, efficiency and transparency — to combat fraud and corruption in government purchasing.

3. An analysis of the *modus operandi* of cartels in government purchases under the aegis of Law no. 8,666, 1993

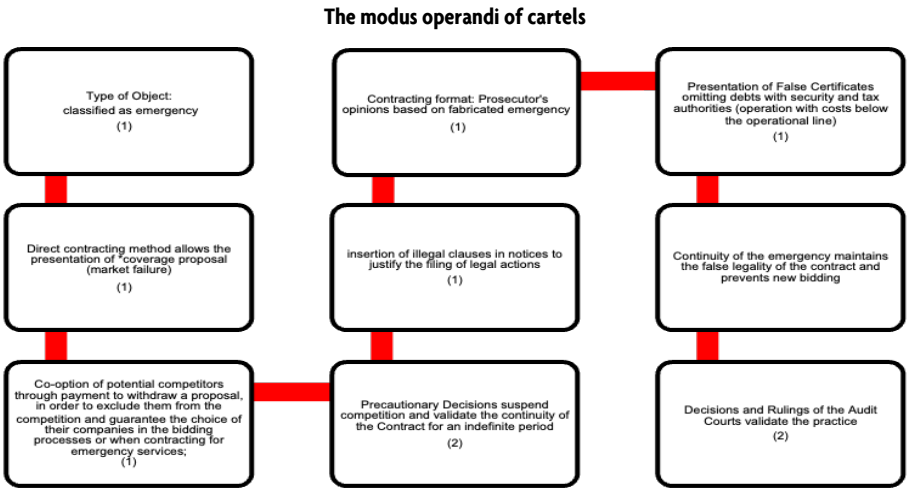
As demonstrated in the previous chapter, cartels generally take advantage of the legal order of bidding to engender their unfair market practices, acting in the same way on the two fronts that make up government purchases: the elimination of competitors and the corruption of officials who represent the State as plaintiff and, ultimately, as judging bodies. It should be noted that the State is, on the one hand, a buyer of goods and services, when the public administration purchases products from existing companies on the market, and, thus, dictates the purchase rules through the use of bidding law. At the same time, it is the arbiter responsible for defining the successful company, which allows cooptation of its officials, who may structure the procedure that ensures maintenance of fraud and corruption practices, including at the highest judicial level, which will guarantee the success of the cartels. This *sui generis* position of the State in government procurement market, as both consumer and judge, creates a market condition beyond the control of the Administrative Council for Economic Defense (Cade) and the rules vis-a-vis the consumer code between suppliers and customers, raising a question long neglected by the legal system for bidding.

Here we present a simplification of the *modus operandi* of cartels in government purchases, showing that all illicit activities of companies and

[19] BRASIL, Lei nº 14.133, de 1º de abril de 2021, Lei de Licitações e Contratos Administrativos, op. cit.

government officials occur under the false legality permitted by rules set out in Law no. 8,666/1993.

Figure 1
The modus operandi of cartels20 in the government procurement market according to Law No. 8,666/1993



(1) First Order Corruption
(2) Second Order Corruption

Source: Vision law prepared by the authors.

The previous *vision law* demonstrates there control and guarantee of contracts by cartelized companies has grown, with the inclusion of high-ranking officials, administrative courts and judicial bodies — the subject of co-optation with regard to judgment of public procurement processes — demonstrating the extensive activity of cartels, including within the scope of administrative and judicial courts.

With identification of the *modus operandi* of cartels in public procurement, police operations were intensified, especially in state and municipalities more susceptible to harassment from cartelized companies. However, such operations did not reduce company willingness to take advantage of this market failure

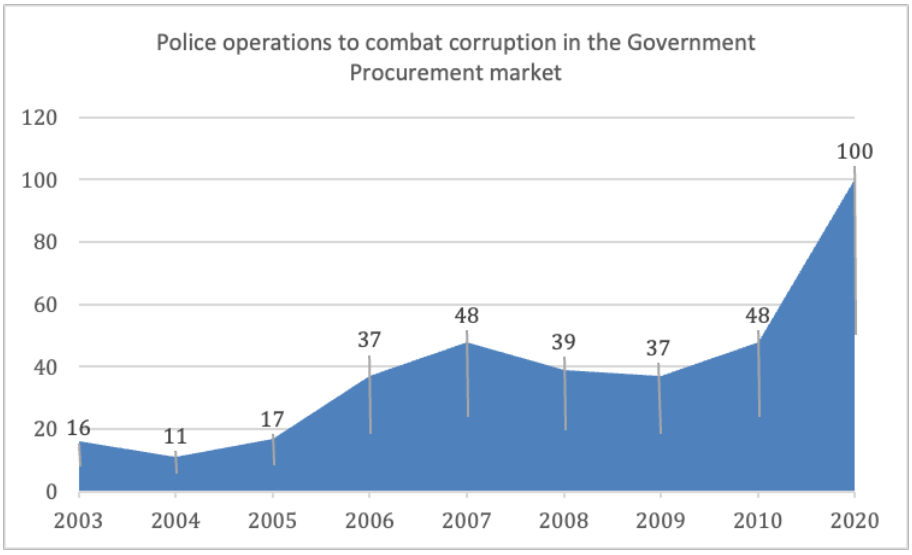
20 Structure based on the articles: *Compliance as a tool to fight cartridge Creation in public bidding and corruption*; Emerson Borges at all; Meritum 2020 and; Fighting or supporting corruption? The role of public sector audit organizations in Brazil; Critical Perspectives on Accounting.

recognized by national regulations. The next section will identify Federal Police action against cartels and corrupt officials and, at the same time, the legal inability to contain unfair market practices.

4. Police operations and combating effects of cartel practices in the government procurement market

In Brazil, police operations to combat corruption in bidding processes have intensified in recent years, but a more accurate look at consolidated data reveals that, with the exception of the valuable work carried out by the Federal Police with the support of the technical department of the Public Prosecutor's Office, the effects and not the causes of corruption have been investigated. It is important to highlight that cartels — criminal organizations, commonly called — have multiplied, always using the same *modus operandi*, which can be seen by the increase in the number of police operations launched in recent years, which did not result in a reduction in cartel activities. Thus:

Graph 2
Evolution of police operations to combat corruption



Source: Polícia Federal (2021) and Costa, Machado and Zackseski (2016).

From 2003 to 2010, when data on operations carried out by the Federal Police was first consolidated and published on the Federal Police Department

(DPF) website, investigations related exclusively to combating economic corruption jumped from 16 to 48, maintaining this average in the years 2007 to 2010, the last year in which the DPF stratified data related to crime and corruption, from 2011 presenting its operations as a whole. In this time frame corruption practices and fraud in public procurement have not decreased but, on the contrary, remained constant.

The results of the study carried out by the Escola Superior do Ministério Público da União (ESMPU), draw attention to the high incidence of filing, by the Public Prosecutor's Office, of processes arising from Federal Police operations to combat bidding crimes. This happens because, to determine the objective of the investigation, the Public Prosecutor's Office may make a request for further diligence, manifestation of a denunciation or archiving, on the understanding there lacks evidence of criminal authorship or materiality.

Table 1
Percentage of police investigations into bidding crimes filed by the Public Prosecutor's Office in 2012

F.U	COMPLAINT	ARCHIVED	TOTAL	% ARCHIVED
SP	6	31	37	83,78%
DF	16	75	91	82,42%
PR	6	25	31	80,65%
PE	7	21	28	75,00%
OTHERS	118	295	413	71,43%

Source: Costa, Machado and Zackseski (2016).

Although the data is from 2012 and, to a certain extent, outdated, it is important to highlight that, in the procedural instruction phase, on average, 70% to 80% of police investigations (IPLs) are closed due to lack of materiality or evidence of authorship. As the research authors highlight: "The participating public prosecutors (interviewers and focus groups) were unanimous in pointing out flaws in investigations conducted through police inquiries and report different impressions regarding the percentages of completed surveys returned for further investigation."

A more up-to-date study of the development of allegations in criminal actions and processing within the scope of the Judiciary may lead to the obvious conclusions as to archiving and annulment, confirming there was a failure in the criminal proceedings related to bidding crimes, resulting in findings of the absence of just cause (materiality/authorship).

As an example, we have included in Graph 2 operations to combat fraud in government hiring in 2020 during the most acute phase of the Covid-19 pandemic, when the Federal Police refocused its operations on combating corruption and economic crime. That year, the Federal Police registered 100 operations,[21] against embezzlement of public funds through fraudulent acquisition of goods and services by public entities, among which are: *Vírus Infection, Placebo, Para Bellum, Sangria, Nudus, TRIS IN IDEM, S.O.S* and *Covid-19*. This demonstrates that there has been a slowdown in cartel activities. Thus, it can be concluded that the investigations leading to the prosecution of acts of corruption and economic crimes, in general, address recovery of losses to the State and society caused by cartelized companies and their facilitators and not the causes that lead to these eventualities.

In the article "O compliance como ferramenta de combate à criação de cartéis em licitações públicas e corrupção", ("Compliance as a tool to combat the creation of cartels in public tenders and corruption"), Emerson Borges de Oliveira, Guilherme Bohac and Nayara Ferras identify the points raised in Criminal Action 510-STJ, concerning Operação Jaleco Branco, carried out at the headquarters in the state of Bahia, aimed at combating alleged cartel formation in state bidding processes. Thus, the structure set up by cartelized companies to monopolize hiring in that state is a practice already known by economists, as "imperfect competition". In this operation:

> Bids, in the group's area of activity, were always preceded by an adjustment between to decide who would appear as a competitor and who would win the contest, in order to eliminate free competition in the public tender.
>
> The winner chosen by the gang, as compensation for winning the Government contract, made payments in cash or delivered goods, generally vehicles, to competing businesspeople and those who withdrew from the contest.
>
> In this way, everyone involved benefited from the contract, to a greater or lesser extent, depending on the potential of their companies and

[21] SITE DA POLÍCIA FEDERAL: Polícia Federal completa mais de 100 operações contra fraudes relacionadas às ações de enfrentamento à pandemia. Available at: https://www.gov.br/pf/pt-br/assuntos/noticias/2021/07/policia-federal-completa-mais-de-100-operacoes-contra-fraudes-relacionadas-as-acoes-de-enfrentamento-a-pandemia. Accessed on: 21 Feb. 2022.

effective participation in the fraud.[22]

For the authors, the practice of cartels in public procurement was identified a number of times in recent years, resulting in a large number of police operations. Taking the aforementioned authors as our starting point, we may identify illicit practices and fraud perpetrated by cartels operating in the government procurement market, as follows: (a) The price fixing among the participants in the tender takes place well before the bidding session, or the sending of proposals provided for in the old regulation, still in force, Law no. 8,666/1993 and its related Law no. 10,520/2000, with revocation deadlines scheduled for April 1, 2023, the date from the which public purchases will be governed exclusively by the new regulatory framework for bidding and administrative contracts; (b) the reduced number of bidders offering goods and services, in most cases, facilitates price fixing and eliminates the possibility of a dispute over the lowest price, even where the law establishes the possibility of bids or offers to reduce prices. In practice, what happens — the difference between *the is and the ought* — is an advance agreement between companies or between companies and corruptible public officials; (c) the survey of prices presented in the bidding rules to parameterize government acquisitions prices, compared to market prices, are reduced to the same suppliers, a practice that cannot be curbed, since the law does not establish any restriction on the participation of the same suppliers vis-a-vis research by the purchasing sector — the known coverage proposals; (from exacerbated formalism that leads to the elimination of competitors to imposition of legal restrictions through the direction of tender announcements. The requirement for certificates and technical certificates, which in their origin mean to prevent entry of economically unsound companies, generates an excess of legality, with inefficient results, and the consequent maintenance of high prices — hence the extreme formalism; and, (e) the occurrence of the deadline — risk of non-receipt — removing competitors who may win the bid and are not participants in the price control scheme imposed by cartelized companies, in collusion with officials representing administration on the demand side.[23]

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[22] OLIVEIRA, Emerson Ademir Borges de; HARO, Guilherme Prado Bohac de; FERRAS, Nayara Iraidy Moraes. O compliance como ferramenta de combate à criação de cartéis em licitações públicas e corrupção. *Revista Meritum*, Belo Horizonte, v. 15, n. 2, p. 321-339, maio/ago. 2020. DOI: https://doi.org/10.46560/meritum.v15i2.8162.

[23] Ibid.

With the exception of the deadline, all other practices implemented by the cartels, even those highlighted in police operations combating cartel formation, were not encoded in law, nor received due treatment with respect to economic law, leaving it up to the courts and law practitioners to apply the scope of administrative law. Thus neglected, corruption and fraud flourished, as companies and public officials facilitated legal benefits for transgressors, even during police operations, encouraging entry of new companies into the cartel system or the return of transgressive companies, in an endless cycle of combating the effects and maintaining the causes. In this sense, Nóbrega observes:

> In doctrine, a review indicates that the legal study of bidding rarely attempted to explain, predict and understand the behavior of the actors in the processes of public procurement. Most of the time, the work of jurists remained confined to mere descriptive analysis of the norms established in law.[24]

This demonstrates that ex post action to combat corruption, even if extremely necessary, is incapable of mitigating the actions of cartels and preventing the co-optation of civil servants. In this regard, we will discuss the advances provided by the new regulatory framework of government purchases and new compliance tools, by the legislator, with a view to exercising ex ante control based on risk management.

5. The new Law no. 14,133/2021 and the three lines of defense for risk management against bidding fraud

In private organizations, corruption and fraud are treated as business risks to which all companies competing in the market are subject, be it internal misconduct, information leakage to competitors, data theft or financial embezzlement. Internal audits work together with IT security and, in many cases, rely on the external audits. This fight against fraud in the private sector is considered "risk management". Such behavior demonstrates that fraud and corruption are not restricted to government purchases, but are, rather, a phenomenon of the competitive market which, if not controlled, can lead to

[24] NÓBREGA, Marcos. *Direito e economia da infraestrutura*. Belo Horizonte: Ed. Fórum, 2019. p. 21.

the absorption of high costs in any business sector, whether on the demand or on the supply side (exclusion of suppliers and raising prices of goods and services for the government).

Treating corruption as a business risk — market failure — not as a crime, strictly speaking, is a *sine qua non* issue to mitigate the formation of cartels in the purchasing market. To paraphrase professor Eros Grau — recognizing corruption as a criminal act will not prevent cartels from manifesting themselves in the real world — the world of being. The question that arises is: how can we structure a control and prevention system — not simply combative — to tackle fraud and corruption in the governmental purchasing sector in line with the private market?

The new regulatory framework for bidding and contracts, Law No. 14,133, April 1, 2021, took a big step in this direction, incorporating numerous principles and rules consolidated in the USA and parts of Europe, which address results-based government purchases. In these countries, goods and services purchased by the government should only be those that provide a result which is genuinely useful to the population. The new legal system for public tenders in Brazil expands the principles of the old, obsolete one,[25] in article 3 of Law no. 8,666/1993 and widely disseminated in administrative law, incorporating market principles into the rigid legalistic system imposed in 1993. Thus:

The new Tenders and Contracts Law adopts the compliance model already widely used in the private market, incorporating in the legal framework of public procurement principles of efficiency and effectiveness, planning, transparency and segregation of duties. These principles, together, eliminate exacerbated formalism and mitigate the influence of cartels on government demand, enabling the structuring of a risk management system through lines of defense capable of tackling corruption in the bidding processes.

Law no. 14,133, enacted on April 1, 2021, includes, in article 5, various descriptors, including efficiency, planning, transparency, the effectiveness and segregation of functions, collected from the legal system of the countries that use common law, combined with regulations present in the infralegal government procurement regulations, but not incorporated by law no. 8,666, 1993.

The principles of efficiency and effectiveness come to the rescue in the government purchasing market, in terms of the economic concept of cost-benefit, so that agreements between the government and companies that supply goods

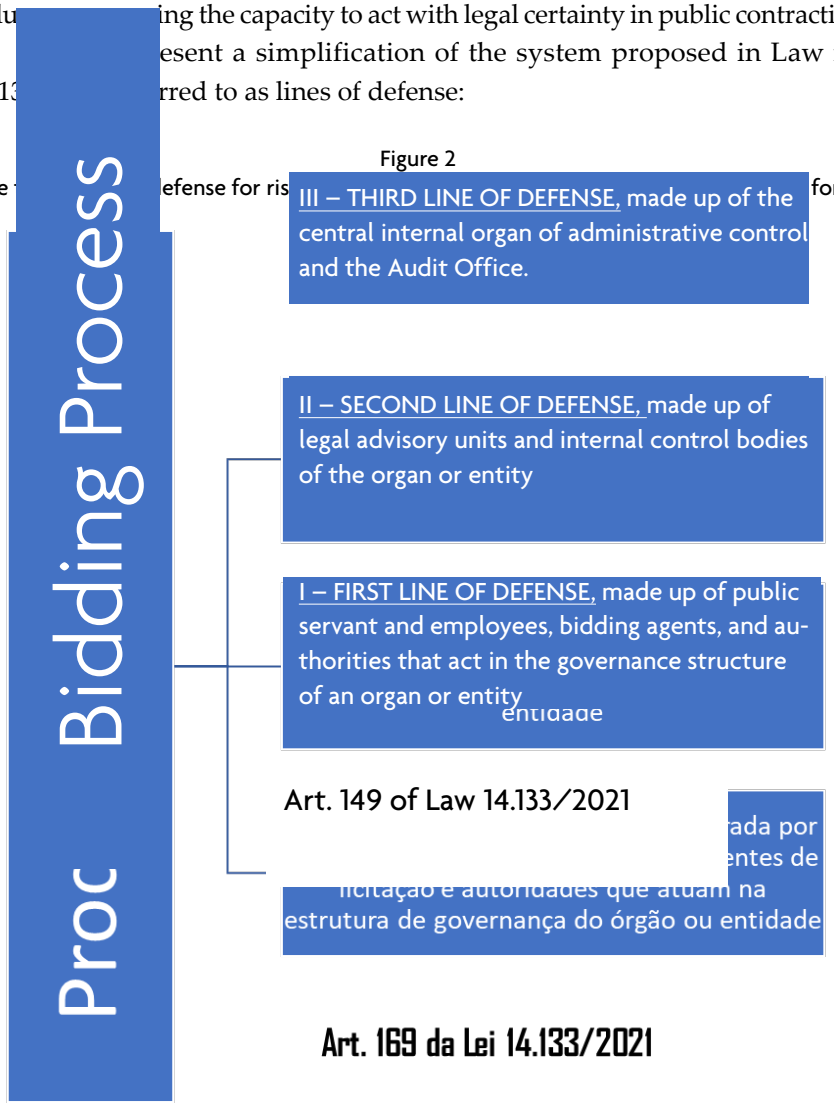
[25] Acronym for the common principles of Public Administration: legality, impersonality, morality, transparency and efficiency.

and services guarantee resources allocated are converted into real benefits. The principle of planning is embedded at management level, enabling reduction of emergency, unnecessary or excessive purchases.

On the other hand, segregation of functions and management by competence, limiting decision-making power in the hands of a few officials, minimizes cartel influ ing the capacity to act with legal certainty in public contracting. esent a simplification of the system proposed in Law no. 14,13 rred to as lines of defense:

Figure 2

The efense for ris for in



Source: Own research, adapted from Law No. 14,133/2021.

The lines of defense established in the new Bidding and Contracts Law (LLC) apply to employees who work in administration, law, and internal and external

control bodies, aimed primarily at consolidating continuous and permanent risk management, and the preventive control of fraud and corruption, in one of the most sophisticated systems in the private market.

The first line of defense, the responsibility of the administration plaintiff, incorporates the principle of planning, employing tools such as Risk Matrix in the process of acquiring goods and services and Annual Hiring Plan. These tools alone curb the proliferation of emergency contracts and the occurrence of delays due to fraud in the bidding processes, which results in greater efficiency and effectiveness.

The second line of defense, in turn, rescues the prior control of legality by identifying legal advice as responsible for assessing the essential elements for contracting and exposing the assumptions of facts and rights (art. 53). It is important to highlight that in previous legislation the legal advisor worked as a mere reviewer, completely dissociated from the control of bids.

The third line of defense imposes limits on the decision-making power of the administrative courts, mitigating the danger of reverse damage in the decisions of those courts of accounts and, consequently, reducing the so-called second-order corruption carried out by cartels. In practice, the Audit Courts become compliance bodies, recording their decisions based on the principle of public interest, and presenting alternatives to the malpractice (formal improprieties, errors or failures) to be implemented by the administration, which, ultimately, should eliminate so-called precautionary decisions that facilitate emergency hiring.

Finally, the technical information reports — which make up the instruction procedure necessary for the value judgment of the reporting counselor presiding over the process — must present propositions and alternatives for correction of procedural flaws in the same way as external audit for private companies, guiding and ensuring the smooth running of contracting activities and public administration services. As argued in article 75, the objective is to prevent personal interest and biased interpretations interfering with the presentation and treatment of the facts.

In general, with precautionary decisions by administrative courts based on *fumus boni iuris* and *no periculum in mora*, based only on fragile reports of irregularities, there was little or no effect combating corruption; on the contrary, they enabled the practice of cartels. On the other hand, the *Termination Decisions* were vague or minimal, proving useless in guiding administration in the correction and prevention of procurement errors.

The repositioning of administrative courts as compliance bodies is a great advance in Brazilian legislation, since these bodies are, ultimately, those, in public administration, with the greatest knowledge and technical capacity to propose risk management solutions for the government procurement market.

Another advance of the new bidding law was the repeal of articles 89 to 108 of Law no. 8,666, June 21, 1993, which dealt with public tender crimes, and the inclusion of Chapter II-B of Heading XI of the Special Section of Decree-Law No. 2,848, of December 7, 1940 (Penal Code), correcting a flaw in the inspection process of contracts signed between public administration and companies providing goods and services. It added twelve categories to the criminal code in relation to the practice of corruption, leaving the bidding code only to regulate the administrative contracts and tender regime, notwithstanding penalization of illegal acts committed in the conduct and process of bidding. This repositioning prevents administrative courts acting as judicial ones, reducing the influence of cartels over judges.

Conclusion

The low probability of conviction in public tender cases motivates the continuance of first and second order corruption. Decisions are rational, comparing advantages obtained from illicit activities (fraud or cheating) with the calculation of possible arrest and conviction and, indeed, the leniency of the sentence.

Operations undertaken by the Federal Police, such as *Operação Jaleco Branco*, most with the technical support of the Controller General of the Union and the Public Ministry, were based on the same investigative and procedural instruction model, identifying offenses against the principles of legality, impersonality, morality and transparency to identify the practice of cartelization in government procurement.

Thus, as the core issue was not addressed, the offer of goods and services to municipal and/or state governments were once again controlled by a new group of suppliers, which in some cases were companies made up of the same associates, or partners of those targeted in police operations. Despite their impressive names, police operations demonstrated how the legal apparatus was unable to identify corruption and fraud as a danger to the market, to be combated with more consistent compliance tools. Some remained mired in

the scope of the Judiciary, as cartels reproduced in the shadow of the obsolete Public Procurement Law.

The lesson from such police operations is the absence, in the Brazilian legal system, of a set of laws and regulations adequate to economic reality, capable of mitigating the high social costs of bureaucratic crime arising from a lack of healthy competition in government tenders.

The new Bidding and Contracts Law appears to balance the effects of impoverished competition in the public procurement market, implementing tools from other countries and the private market, such as prior control of legality, contracting planning and the risk matrix of goods and service contracts for public authorities, to impose legal guarantees on risk management and compliance.

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