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Corruption in public procurement

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Fair competition and equal treatment of bidders are fundamental concerns in the development of the new EU-rules on public procurement. A critical threat to the attainment of these objectives is the presence of corruption. Bribery-induced violations of procurement procedures can be carried out in many different ways. The offences can still be categorized in two groups:

i) Hidden violations of procurement rules: It looks like as if the rules have been respected.
ii) Legitimate deviations from procurement procedures: Rules of exception (such as EU, 2004:Art. 30 and 31) are too frequently exploited.

This note will concentrate mainly on the first category, discussing grey zones more than clear-cut bribery.[1] First some basics about the topic will be discussed.

The problem of corruption is its tendency to replace public welfare as the fundamental concern in public institutions, with the personal interest of employees. Corruption can thus be defined as the misuse of public office for private gain. The damage of this misuse lies in the influence on choices and the introduction of inefficiencies. Public expenditures increase as prices are inflated and not the main concern of the tender procedure. Also quality may cede for a bribe, perhaps resulting in roads full of holes, buildings not proof to earthquakes, consultants unable to advise. Moreover, corruption affects the allocation of public resources. Projects more likely to produce opportunities to obtain bribes are preferred, large construction projects are typically given priority to health and education projects. In countries where corruption is endemic, rent-seeking becomes a serious issue affecting most aspects of public life and undermining the general confidence and respect for the bureaucracy, politicians, formal laws and regulations.

Corruption takes the different forms of *facilitation payments*, inducements to get things done, and *grand corruption*, significant amounts offered to politicians or high-level officials capable of influencing large contracts. We draw a distinction between bureaucratic and political corruption, between active and passive bribery, and between public and private-private corruption. The critical importance of proof in cases of corruption, makes us also apply alternative terms when debating the issue, such as *undue business practices*, *bid rigging, predestination of contracts, low quality business climate, irregular trot, feeling of connections, extra legal activities, etc.*

Corruption is more common in some geographical areas than others and more widespread in certain industries. The risk of corruption is present in all countries, public procurement being the most exposed activity. This challenge has been a main topic in a survey conducted by the author among Norwegian business leaders (Soreide, 2004), The Confederation of Norwegian Business and Industry (NHO) assisted appreciably to the study. 82 executives with significant experience from international trade responded to a questionnaire with close to 100 questions, all related to corruption. The survey also included interviews at high executive levels in several large firms. The study will be referred to

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[1] Examples and more precise information about corruption in public procurement can be found in Rose-Ackerman (1999), Della Porta and Vanucci (1999), Weber (2003), Soreide (2002) and on the homepage of Transparency International (www.transparency.org).

throughout this note with a focus on the responsibility of private firms. The less debated issue of accountability of public officials is nevertheless also essential.

Not exactly corruption

Procurement procedures will often make it difficult for a private firm to offer a bribe and obtain the promise of a big contract. A more common motivation behind bribery is therefore to obtain just a higher probability of gaining the contract, for instance through secret information about the tender, the other bids or evaluation criteria. The "price"(bribe) is lower as the "customer" (the private firm in this setting) is not guaranteed the good. These inducements are often not large enough to be considered "real bribery".

Between totally acceptable marketing procedures and clear-cut corruption there is, accordingly, a grey zone of practices with an unclear legal status. Marketing strategies challenge the definition of corruption when benefits of significant private value to the public official/client are offered, particularly when having a job-related aspect like business-excursions and tickets to arrangements where also job-contacts are invited. Drawing the line between unethical inducements and acceptable practices can be difficult, particularly as the potential of being influenced, for instance by a ticket to a world championship or a diplomatic visit to the US, varies between clients and between individuals. Several of the persons interviewed for the survey acknowledge that the intention behind marketing and gifts is similar or identical to the purpose behind bribery. Among the respondents, 26% offer valuable tickets to clients while 36% offer excursions, the practices clearly being more common in sectors perceived to be among the more exposed to corruption. Still, these sectors also include firms with a clear policy never to offer clients gifts or excursions.

The survey aims at clarifying the meaning of *gifts* in this setting. During interviews it was made clear that gifts or "bribes" requested can be very small, also in countries where the level of corruption is perceived to be high. In countries where gifts often are "expected", it can be sufficient to offer small gifts at values far below what we call bribery, "ridiculous items like cheap souvenirs or chocolate" – in the words of one interviewee. Firms that misinterpret a culture in this sense may offer gifts or bribes that are too valuable, thereby encouraging corruption and disturbing the local business culture.

Similar to marketing strategies, contact at an early stage is often a prerequisite for participation in business. 2/3 of the respondents, with a majority among firms facing high competitive pressure in their main markets, find such contact essential or an obvious benefit. Obviously, the contact is in itself not corruption. In some cases it even represents an alternative to corruption as personal relationships can prevent the impact of a bribe offered by a newcomer. Even so, early stage contact is needed to establish the mutual trust necessary to make illegal corrupt deals on big contracts. A high reported impact of pre-tender contact will seldom be completely compatible with free and unbiased competition, and will not characterize a healthy business environment. There is generally a stronger reason to suspect corruption when early stage contact is facilitated by middle-men.

The rules of contact and communication in procurement are particularly exposed to violations. Secret information about the other firms' bids or about evaluation criteria is one of the most common reasons to offer bribes, according to the aforementioned study. Also, 49% of the responding firms negotiate all through the tender procedure. Just 1/5 of these respondents claim that relevant communication is copied to all tender participants. The tendency to negotiate all through the tender is clearly more common among the largest firms. The contracts are larger and more complex at this level, and will often include details that need thorough discussion. These are aspects that also will make it easier to cover corruption. The new rules recognises this risk, accepting the need for negotiations while also emphasising that these procedures "must not be used in a way to restrict or distort competition" (EU, 2004: Art. 29, and Art. 31 in the foreword). Violation of communication rules is not categorically a result of corruption or a lack of respect for the rules among firms that take part in a tender. The client/public official can have other incentives to inform one or several of the firms about secret tender information, for instance to press down prices or to make a certain firm win the tender just because the

client is satisfied with its past performance. The information is sometimes presented in a way that makes the firm unable to prevent that it is being informed.

Technical consultation, bid rigging and predestination

Due to their high expertise, private firms are often asked to advise clients/public institutions on technical parts of tender specifications, even if being among the competitors for the contract (as opened for in EU, 2004: Chapter VII, Section 2). This consultative service will in some cases represent an opportunity also to influence the specifications in a direction that benefits the firm itself, or a firm that it cooperates with. 33% of the survey respondents are frequently "able to influence or asked to advice clients on tender specifications." 41% find tender specifications to often "fit with the offer of one specific company," a result that clearly indicates what we call *predestination* of contracts. The qualifications required may be specified to match the comparative advantages held by the bribing company only. The benefiting firm will thus offer the lowest price and the formal procedures behind the choice of contractor can be justified. The technical tender procedure appears correct while still, perhaps, functioning as a cover for corruption.

The choice of technology will also affect what sub-contractors to use, and also smaller firms can have incentives to influence complex contracts. However, the problem of predestination applies for public contracts of all sizes. There is no difference between firms of different size and their perceived extent of predestination. Small and medium sized firms appear just as exposed to this problem as larger firms. The differences follow the business sectors. Predestination appears more common in telecoms/IT, construction and oil, gas and power transmission (in that order), sectors that are considered exposed to corruption.

Political pressure

A considerable share of the survey respondents are frustrated about political influence on international tenders. 32% frequently experience that a "competitor has won a contract by help of political pressure", 47% never or seldom experience this problem. The pressure takes the form of a subsidy, like export-credit deals, aid to the buyer linked formally or informally to the purchase, diplomatic or political pressure, commercial pricing issues, impediments to trade or tied defence/arms deals.

This kind of influence is destructive because it reduces the prospect of ending up with the outcome most beneficial to private welfare locally. The link to corruption becomes clear when the privileged firm has paid its own government to put pressure on the client.[2] However, also without such a payment it resembles corruption. The local welfare implication of such political influence are independent of an encouraging payment between the bidding foreign firm and its own government. Besides, the client/the relevant state is in effect bribed by the contractor's government, while the responsible minister can "brag" about jobs and exports (without mentioning the fact that such jobs are subsidised).

Political pressure in international tenders can also be applied by the local government, typically in the form of a quid pro quo. This is a "reciprocal exchange", a compensation from the firm for the benefit of being chosen as the contractor on a big project. 18% of the survey respondents frequently meet such demands, while 33% seldom do so. It is not always clear what the content of the "compensation" should be. Many firms, particularly multinationals, offer various forms of local contents during contract negotiations to show that they will operate responsibly in the local society, i.e. building a school or infrastructure, or using local human resources. It has been argued that social responsibility or the inclusion of such local contents, is a form of bribery as it may induce a government to make a certain choice of bidder. Such suspicions are in some cases justified, and local contents are able to

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[2] The pressure can also be a threat about political sanctions. According to the survey respondents, it does happen in some countries that firms pay their own politicians (for instance in the form of party financing) to sanction a client, or the client's government (when the client is a firm), after the contract has been given to "the wrong firm", a competitor.

cover corrupt transactions (Bray, 2005). However, the same local content can be demanded from the chosen bidder, independently of which firm this is. Besides, a benefit to the society is not supposed to privately profit the person in charge of the contract procedures. While development implications of local contents in business contracts varies a lot (Heum et al., 2003), it is important not to lump it together with the criminal act of bribery.

New rules and the risk of corruption

The risk of corruption can be reduced, not removed, by procurement reform. The new rules are expected to increase competition and improve transparency. More competition reduces prices and improves welfare. However, firms exposed to competitive pressure are also more likely to apply unethical business practices (Soreide, 2004). The link between competition and corruption is unclear in the literature on corruption. Empirical studies that find a correlation between corruption and market power have sometimes failed to include an important dynamic aspect. Firms in competitive markets pay bribes to obtain market power, and change thereby the industrial organisation. More competition for public contracts should therefore be carefully watched by antitrust-institutions. The incentives for tacit collusion are obvious, and collusion is facilitated by corruption.[3] To measure this kind of problems it is important to consider the abovementioned mutual trust that is necessary to make illegal deals. An evaluation of the internal organisation of procuring entities can therefore be an imperative part of procurement reform.

The impact of new rules on the challenge of corruption have regularly been overestimated. Whereas 55% of the respondents to the survey do not think tender-rules prevent corruption, just 6% consider tender-rules an *efficient* obstacle to corruption. In spite of its propensity to undermine the purpose of procurement rules, the issue of corruption has often been neglected in preparations to procurement reform. Reduced corruption has repeatedly been considered a side-effect of new and better rules. The World Trade Organization decided in February 2003 to exclude the topic in their debates about transparency and procurement reform "because corruption is a moral issue" and therefore not in the domain of the WTO (Weber, 2003:38).[4] This is overly optimistic, particularly as most public bureaucracies still fail to actively reward good conduct in a way that reduces the employees' material incentives to misuse power. The promises of business leaders and the words in their codes of conduct will not always have an impact on their actual incentives. The challenge of corruption requires more than moral or ethical conclusions. Judicial tools are insufficient unless the risk for those involved in corruption is increased.

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[3] Corruption facilitates tacit collusion because it reduces the participants' incentive to cheat. With an honest public official, cheating means to offer a lower price than the cartel and thereby provide the firm with the short-term gain of winning the specific contract. When the public official is corrupt, on the other hand, the cheater commences a competition in bribes. The dishonest public official benefits, while the firm is not guaranteed the contract. Corruption will therefore make tacit collusion and cartels more stable (Lambert and Sonin, 2003).

[4] Weber (2003) discusses the problem broadly. The WTO discussion referred to can be found in "Report (2003) of the Working Group on Transparency in Government Procurement to the General Council", para.14. See also WT/WGTGP/M/18 and WT/WGTGP/W/41, available on the WTO website.

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