Fighting Corruption and Promoting Integrity in Public Procurement



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Foreword

The OECD has been at the forefront of global efforts to fight corruption and enhance integrity. Public procurement – the purchase of goods and services by governments – is an area that warrants special attention in the fight against corruption. It typically accounts for about 15% of GDP in OECD countries and is highly exposed to corruption. Both public and private actors may be easily tempted to divert goods and services or money for their personal use. The *OECD Global Forum on Governance* is helping to promote greater understanding and catalyse further action to prevent, detect and sanction corruption in the area of public procurement.

A Global Forum conference on "*Fighting Corruption and Promoting Integrity in Public Procurement*" was hosted by the French Ministry of the Economy, Finance and Industry and took place on 29 and 30 November 2004 in Paris. The OECD gratefully acknowledges the hospitality of the Forum's host and thanks all participants whose energy, expertise, and experience made the event a stimulating exchange of ideas. Participants hailed from both the public and private sector, as well as from non-governmental organisations, trade unions, academic institutions, international and intergovernmental organisations.

Committed to business and government integrity, transparency and accountability, the OECD has developed various initiatives to fight corruption and promote integrity which also extend to public procurement.

OECD's core anti-bribery work is based on two groundbreaking instruments adopted in 1997 by OECD Members and associated countries: the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* ("the Convention") and, the Revised *Recommendation on Combating Bribery in International Business in International Business Transactions* (the "Revised Recommendation"). The Convention was the first binding international instrument to impose criminal penalties on those bribing foreign public officials in order to obtain business deals, and provides for monitoring and evaluation through country peer reviews. The 1997 Revised Recommendation complements the Convention by focusing on deterrence and prevention of foreign bribery. Since the Convention's entry into force in February 1999, the 36 Party countries have been monitoring participating countries' implementation and enforcement of both the Convention and the Revised Recommendation.

Fighting corruption in public procurement in general as well as in aid-funded procurement are also integral parts of the 1997 Revised Recommendation. The OECD's Development Assistance Committee (DAC) has been working with developing countries over the last decade to strengthen procurement systems and fight corruption.

Integrity in public life is a prerequisite to public trust and a keystone of good governance. The OECD supports governments in ensuring high standards of conduct in the public service and has developed policy guidelines to help countries develop and modernise their legal, regulatory, and procedural frameworks to promote integrity and

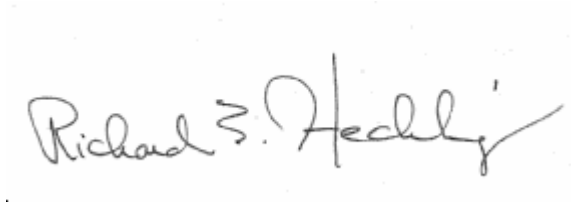
prevent corruption. The 1998 *OECD Recommendation on Improving Ethical Conduct in the Public Service* provides a set of management principles, including guidelines for interaction between the public and private sectors. In the specific area of public procurement, the 2003 *OECD Recommendation on the Guidelines for Managing Conflict of Interest in the Public Service* provides an instrument for reviewing and modernising countries' conflict-of-interest policies. In addition, the OECD, together with the European Commission, has carried out reviews of national public procurement systems in Central and Eastern Europe to help countries modernise their public procurement laws.

The OECD has, as follow-up to this Global Forum event, initiated further work to review risks in public procurement. The Working Group on Bribery in International Business Transactions, the body responsible for ensuring enforcement of the OECD Convention on Foreign Bribery, engaged in an effort to enhance understanding of the methods and techniques used in cases of corruption in public procurement. The Public Governance Committee started, via the expert meeting on Integrity in Public Procurement, to collect good practices on effective transparency and accountability mechanisms that promote integrity in public procurement from the definition of needs to contract management.

This publication summarises the discussions and contributions to the *OECD Global Forum on Governance* conference held in November 2004 and brings together the main papers prepared for the event.

I wish to thank the authors of the papers, which greatly enriched the discussions. This publication, a result of an OECD-wide effort, was managed by Nicola Ehlermann-Cache of the Directorate for Financial and Enterprise Affairs (DAF). Chapters on Integrity, Transparency and Accountability were prepared by János Bertók and Élodie Beth of the Public Governance and Territorial Development Directorate (GOV). Bathylle Missika contributed work of the Development Co-operation Directorate. Helen Green of the DAF Anti-Corruption Division provided overall co-ordination and editing. Edward Smiley (DAF) and Marie Murphy (GOV) provided technical advice and assistance in compiling this publication.

This Global Forum event constitutes the beginning of even greater involvement of the OECD in the international effort to combat corruption and promote integrity in public procurement. I hope that the fruitful exchange and enthusiasm generated at this event will spark increased efforts and improved co-operation, across a wide range of actors and interests in this global endeavour.



Richard E. Hecklinger

Deputy Secretary-General

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Executive Summary

The *OECD Global Forum on Governance: Fighting corruption and promoting integrity in public procurement* brought together a broad-based and diversified audience from all over the world to discuss methods, conditions and approaches to preventing, detecting, and sanctioning corruption in public procurement–the purchase of goods and services by central or local governments or by state-owned firms.

Attendees of the Global Forum were welcomed to the Ministry of the Economy, Finance and Industry of France by François Loos, Minister for Foreign Trade, who highlighted the ongoing progress both in improving efficiency in public procurement and enhancing the arsenal of tools to fight corruption. He also emphasised the timeliness of combining these multidisciplinary efforts. In his opening address Richard Hecklinger, Deputy Secretary-General of the OECD, noted the widespread recognition of the detrimental effects of corruption–a pervasive plague that increases costs, distorts decision-making, undermines economic growth, diverts public funds away from progress towards important social and economic goals, and undermines trust in public institutions and in government officials themselves.

Public procurement, a major potential for corruption

Substantial transactions between the public sector and the private sector

Discussion and debate throughout the forum made clear that the transformation of public funds into private funds through public procurement procedures presents an enormous potential for corruption. Data regarding the size of public procurement markets are limited. However, available statistics suggest that the amounts involved are very large: the ratio of government procurement markets to Gross Domestic Product is estimated to be over 15%,[1] and worldwide public procurement to be equivalent to 80% of world merchandise and commercial services exports in 1998. Public procurement in the European Union equalled approximately EUR 1.5 trillion in 2002[2]–including the purchase of goods, services and public works by governments and public utilities.

Risk areas for corruption in public procurement

The potential for corruption in public procurement exists in all economies and no sector is free from risks of corruption. However, some sectors were recognised as being particularly exposed to corruption in public procurement, due to the complex nature of the works and the vast amounts of the contracts that are involved (*e.g.* construction of major bridges, dams, or tunnels). Participants noted that international public procurement, that often involves large contracts, can be an especially lucrative target for would-be wrongdoers. Many opportunities for corruption were also identified in the delivery of development assistance, and corruption was considered by many to be the most important challenge to aid-funded public procurement. The public procurement process can be abused through collusion and corruption for the purposes of political party financing, as well.

The difficulties of combating bribery and corruption in public procurement

The shadowy nature of corruption

Global Forum participants agreed that one of the fundamental obstacles in combating fraud and corruption in public procurement is the sheer difficulty in detecting wrongdoings. This difficulty stems from the fact that there is often no clear perpetrator nor victim, rather a group of individuals in collusion, with common interests in maintaining secrecy around their corrupt acts. Discussions made reference to the seemingly inexhaustible creativity of those involved in corruption in public procurement. Corruption in the procurement process is hardly limited to straightforward bribery; many sophisticated means of diverting funds and concealing these diversions exist.

Increasing value for money in public procurement

A salient point was raised concerning the very nature of established procurement procedures and rules. Indeed, public procurement regulations are designed first and foremost to increase competition, to obtain the best price, and to ensure the quality and timely delivery of products and services supplied to public organisations. Prevention and detection of corruption are not primary objectives of public procurement regulations. In addition, the traditional supervisory and oversight systems implemented by governments, multilateral development banks and other agencies as part of the procurement process are not necessarily adequate to detect hidden and often complex methods of corruption.

Towards an integrated and comprehensive approach

Specific methods to tackle corruption in public procurement

There was consensus among participants that different tools and procedures relating to prevention, detection and sanction of corruption in public procurement should be developed and implemented. Throughout forum discussions, it was clear that efficient, rapid, and transparent public procurement procedures and sanctions for corruption are needed. Procedures and sanctions should provide safeguards against abuses, such as malicious stalling of procurement procedures or actions to dissuade victims or others aware of corruption from coming forward.

Multidisciplinary considerations

Participants emphasised the importance of cooperation and input from experts from a range of fields to ensure a rich debate and a full array of complementary ideas to address the issues of integrity and corruption in public procurement. Expertise and experience in fields including international business and trade, competition, public administration and governance, international law, development aid, ethics, and anti-corruption, among others, are necessary components of a comprehensive approach. Diverse viewpoints from the private sector, from public institutions, and from civil society enrich the process of identifying both challenges and solutions.

Participants highlighted that a multidisciplinary approach is also essential to transpose and implement international legal instruments effectively. Professor Mark Pieth, Chair of the OECD Working Group on Bribery in International Business Transactions, recalled that during the drafting of the OECD Revised Recommendation on Combating Bribery in International Business Transactions, good public management and governance through

improved transparency and enhanced bribery prevention were among the key needs identified. Indeed, action to reduce the demand for bribes is crucial and is complementary to the efforts by the Parties to the *Convention on Combating Bribery of Foreign Public Officials in International Business Transaction*, which criminalises the bribing of foreign public officials for the purpose of obtaining or retaining business deals (see Chapter 1).

A provision was included in the Revised Recommendation in support of a World Trade Organisation (WTO) agreement on transparency by which counties would have been invited to take action to fight the demand for bribes. The Revised Recommendation also calls for good management and governance through integrity in international development aid. Finally, the OECD anti-bribery instruments provide for the refusal of access to procurement – or debarment – as a sanction of corruption.

Specific mechanisms to promote integrity and fight corruption in public procurement

Transparency, a pre-condition for accountability

Transparency is crucial for sound decision-making in procurement, particularly where public funds are concerned. There was agreement that transparency is among the most effective deterrents to corruption in public procurement. Transparent procedures allow a wide variety of stakeholders to scrutinise public officials' and contractors' decisions and performance (see Chapter 2). This scrutiny, in addition to other mechanisms, helps keep officials and contractors accountable. Conversely, the lack of transparency creates a haven for corruption. Elena Panfilova, Executive Director of Transparency International Russia, explained the context in Russia where the public procurement arena has shifted from under-regulation to over-regulation and where mechanisms to convey a clear understanding of the procurement process are lacking. Pierre-Christian Soccoja, Executive Secretary of the French Central Service for the Prevention of Corruption noted these and other geographic, structural, cultural challenges in building transparency that face transition economies. He stressed that while the call to fight corruption is universal and leaders in these efforts have come forward in many countries, progress remains scattered.

Transparency alone, however, does not guarantee a procurement process free of corruption. Professor Frédéric Jenny, Chair of the OECD Competition Committee, remarked on the relationship between anticompetitive practices and corruption in public procurement. He noted that care must be taken to ensure that enhancing transparency to fight corruption does not increase the scope for anticompetitive practices and, consequently, to collusion and corruption among bidders. Yet another consideration is how transparency may possibly lead to infringement of intellectual property rights (see also Chapter 3).

In designing transparency rules and procedures, serious reflection must also be given to establishing clear and precise disclosure requirements for various types of information. Rules also need to address when and to whom the information is made available. For instance, it may be preferable that only the content of winning bids be released, to the exclusion of the contents of bids that were not selected. In some cases, this type of information should be made available only to issuers of tenders and controllers, and not to competitors generally.

Harnessing the potential of new technologies

Participants expressed interest in exploring innovative approaches to promoting transparency in procurement using new information and communication technologies. These technologies have become an increasingly important tool in standardising processes, making procedures more transparent, and preventing corruption in public procurement.

Participants reported on steps taken in their countries to increase transparency in public procurement. E-procurement systems implemented in Korea and Mexico are examples that demonstrate the innovative use of information technology to prevent and control corruption in public procurement. Kyung-soo Choi, Head of Public Procurement Service, Republic of Korea explained how in a country where mobile phone use is widespread and where 75% of households have internet access, the electronic processing of the entire procurement process has resulted in significant increases in efficiency, transparency and public confidence. Undersecretary Roberto Anaya of Mexico's Ministry of Public Administration explained that close co-operation with universities, chambers of commerce, non-governmental organisations and other public observers throughout the conception and implementation of Compranet, Mexico's e-procurement system, contributes to increased transparency in government bidding and contracting. Claudio Weber Abramo, Executive Director of Transparency International Brazil, described the electronic procurement system implemented in São Paolo that allows for the systematic, centralised collection of data related to contracts, prices and bidders, which in turn can be used to prevent and detect possible corrupt behaviour.

Providing and promoting the needed skills and training

Training personnel in both public institutions as well as in the private sector is fundamental to integrity in public procurement. Robert A. Burton, Acting Administrator, Executive Office of the President, Office of Federal Procurement Policy, United States underscored the utmost importance of specialised training on rules and regulations, ethics, and accounting to facilitate the detection of corruption. He also emphasised that policies that feature merit-based recruitment and performance-based carrier promotion can contribute to improving integrity among public employees involved in procurement processes.

Richard Kell, President of the International Federation of Consulting Engineers (FIDIC) described FIDIC's anti-corruption tools, which include its codes of ethics and policies on business integrity, conflict of interest, quality, sustainability, and capacity building. In order to be effective, these tools need to be understood and implemented by employees at all levels in daily business, particularly among chief executives. FIDIC's "Business Integrity Management System" ensures that member firms have a commitment to integrity involving all levels of management and that employees also focus on preventing corruption.

Mapping out risk areas at all stages of the public procurement process

A clear understanding of the various procedural steps of the public procurement process can contribute to developing effective preventive means as well as indicators to detect corrupt behaviour. There are many techniques to misappropriate funds and several ways to disguise corrupt behaviour in public procurement. These methods vary and can be applied at various stages of the procurement process. Participants stressed that the risks for corruption exist not only in the bidding process but also in the definition of

needs and in contract management. They acknowledged the benefits of mapping out a number of specific areas: 1. methods used to mask irregularities and project the image of a legitimate operation; 2. techniques utilised to divert funds initially allocated to public projects for illegal purposes; 3. manners in which the diverted funds are usurped; and 4. the exploitation of informal networks to facilitate corrupt operations. Participants suggested that the collection of works undertaken in identifying areas potentially exposed to corruption, including the risk analysis carried out by the French Central Service for the Prevention of Corruption, be systematised (see Chapter 21). Furthermore, they highlighted that a better understanding of the different risk areas in the entire procurement process overall could contribute to the development of adequate mechanisms and indicators that aim to prevent fraud and corruption as well as to help detect misdeeds when they occur.

Accounting, auditing and reporting

Internal control systems may play a key role in tracking systemic failures and detecting irregularities, including corruption in public procurement processes. A comprehensive control system includes audits to review public procurement decisions in appropriate circumstances. Several participants emphasised the need to implement audit procedures that go beyond the customary control measures applied in procurement processes. Audits of companies' books and records, revealing how they conduct business and carry out controls, are especially useful to identify and map out specific risks for corruption. Account audits, which are detailed investigations of a company's stocks and orders, in search of specific irregularities, are far more complex, far more likely to detect corruption, and require auditors with very specific expertise. The latter may notably be important to determine whether companies participating in the procurement process have been involved in fraudulent or corrupt activities in the past.

Additionally and equally important are the rules for reporting suspicions of corruption offences internally within public institutions, as well as externally to the law enforcement authorities. Clear rules that require public officials to report corruption offences of which they become aware in administering the public procurement process are essential. Finally, the public procurement authorities need to be aware of the reporting obligation as well as the reporting channels between the public procurement agencies and the investigative and prosecutorial authorities, and when appropriate, competition authorities. Likewise, rules that require external auditors to declare suspicions that arise in the review of the procurement process or the assessment of company accounts, financial statements and internal controls, should also be established.

Sanctioning misconduct and corruption: the potential of debarment

The need to define the financial and legal responsibilities of participants in the procurement process in regulatory and procedural frameworks was stressed. Some participants raised the issue of criminal, civil and administrative sanctions for violations of the law, both for the procurement entity or its agents as well as for bidders. Sanctioning corruption in public procurement through denial of access to bidding – or debarment – and blacklisting received particular attention. Speakers from international financial institutions that implement debarment and blacklisting policies shared views on these experiences. Participants elaborated on detailed examples in national settings as well. Extensive debate on the issues of debarment and blacklisting brought forward an array of fundamental questions that must be addressed when considering sanctions for corruption. Participants agreed that debarment is a serious weapon and could be a useful

tool. It was also agreed, however, that further consideration and discussion on issues related to sanctions, and to debarment in particular, would be useful. Participants suggested that recent work on sanctions and debarment, in particular within international organisations, be taken into consideration during the upcoming review of the OECD Recommendation on Combating Bribery in International Business Transactions.

Investigating and prosecuting corruption: the issue of immunities

Another aspect germane to the repression of corruption is the issue of immunities and privileges that exempt some from investigation or prosecution of corruption-related offences. In both industrialised and developing countries, contributions to political parties and collusion with high-ranking politicians have been observed, highlighting the importance of transparency in the political process to improve the integrity of public procurement. Eva Joly, Special Adviser to the Government, Ministry of Justice and Police, Norway, advanced that the likelihood of investigation and prosecution faced by ministers and other government leaders who engage in corruption must be increased. In particular, she proposed that their immunities and privileges should be lifted and that those convicted of corruption-related crimes should not be allowed to return to politics at a later stage. Other participants suggested that international organisations might be particularly suited to address political corruption as it relates to public procurement and to evaluate national efforts to fight corruption in general.

What is next?

Improved and increased efforts to fight corruption and promote integrity in public procurement are timely. Those who share these goals should capitalise on a growing intolerance of corrupt practices, on the part of the general public, the business community, and political leaders. The exchange at this Forum contributed to highlighting methods of disguising corruption to determine how and when the public procurement process is at risk; initiated discussion on how to promote transparency and ensure accountability in these processes; and began to formulate approaches and considerations in conceiving and implementing sanctions.

Avenues for future work

The Forum highlighted the importance of a comprehensive, interdisciplinary approach to integrity and anti-corruption work that ranges from awareness and prevention to detection and sanctions. Continued and enhanced dialogue and exchange among stakeholders was also recognised as a fundamental element to promoting integrity and fighting corruption: within government departments, among different countries' governments, and among other stakeholders including civil society, the private sector and international institutions who share the same goals. The following proposals to orient future work of the OECD, based on the exchange that took place throughout the Forum were put forward:

- To **develop an operational guide** to help procurement officers and other relevant agencies prevent and detect corruption. It was proposed that such a guide include a typology of fraud and corruption practices used to circumvent rules as well as preventive mechanisms so as to provide detection tools for areas particularly at risk in public procurement. The guide should also contain practical measures for improving transparency and ensuring integrity in the whole process. The development of the guide would best be achieved by

building on the collaboration established on the occasion of the Forum between the relevant OECD directorates with other national, regional or international organisations. When the work is sufficiently advanced, it could be useful to organise another international event to discuss a draft operational guide.

- To **review the provisions of the OECD anti-corruption instruments** in relation to public procurement to ensure their significance. It was suggested that the OECD Working Group on Bribery address this matter in the framework of its foreseen discussion of the review of the Revised Recommendation on Combating Bribery of Foreign Public Officials in International Business Transactions.
- To **develop good governance principles** fostering transparency, accountability and integrity of public officials in the whole public procurement process, particularly in the definition of needs and contract management phase. Lack of transparency and accountability in public procurement has been identified as a major policy challenge. But the difficulty also lies in defining what type of information should be disclosed, to whom and at what step of the process. The development of these policy principles will draw on practical solutions of the manual guide linked to transparency as well as on good practices identified within a network of policy-makers and procurement practitioners.
- To consider **reinforcing national networks** to combat bribery in public procurement by engaging in exchanges between public procurement offices, competition authorities and judiciary bodies.

Notes

1 This ratio indicates the total government expenditure, including compensation for employees and defence-related expenditure. For further detail see "The Size of Government Procurement Markets, OECD 2002", also available at http://www.oecd.org/dataoecd/34/14/1845927.pdf

2 A report on the functioning of public procurement markets in the EU, European Commission, February 2004; also available at www.europa.eu.int/comm/internal_market/publicprocurement/docs/public-proc-market-final-report_en.pdf.

Part I

Public Procurement: OECD Perspectives

Chapter 1	Fighting Corruption in International Business Transactions: Major Considerations Regarding Public Procurement Mark Pieth Chair of the OECD Working Group on Bribery in International Business Transactions
Chapter 2	Improving Integrity in Public Procurement: The Role of Transparency and Accountability Robert A. Burton Acting Administrator, Executive Office of the President Office of Federal Procurement Policy, United States
Chapter 3	Competition and Anti-Corruption Considerations in Public Procurement Frédéric Jenny Chair of the OECD Competition Committee
Chapter 4	Development Assistance Cooperation: How Building Procurement Capacities Can Help Improve Integrity Richard Manning Chair of the OECD Development Assistance Committee

Chapter 1

Fighting Corruption in International Business Transactions: Major Considerations Regarding Public Procurement

by

Mark Pieth*

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Professor of Criminal Law, University of Basel, Switzerland

The OECD Global Forum on Governance attracted experts from many professions and from all parts of the world. This success reflects the fact that contracts subject to public procurement make up a considerable proportion of contracting overall; analysts estimate a figure of up to 80% of the world merchandise and commercial services exports. The broad range of participants also indicates a shared perception that there is a real risk of subverting public procurement by means of corruption.

Considering the key sectors of construction, especially large infrastructure projects like bridges, tunnels, motorways, railways, harbours and underground systems; or engineering in a broader sense, including power stations, hydroelectric dams, mining infrastructure or oil and gas equipment, it is easy to discern the dimensions of the projects we are talking about. One would need to add defence contracting and civil aeronautics, again key areas where state procurement agencies are involved. Both in developed and in developing countries, the risk of manipulation is considerable.

Multilateral lending agencies, international organisations and regional economic organisations have developed detailed procurement rules. Nation states have implemented them. Until now, the primary focus of procurement rules has been to secure the best value for money. Only gradually did it become obvious that the prevention of bribery is one of the fundamental concerns in ascertaining that the best and the relatively priciest bidder get the job rather than the best rent-seeker.

Risks for corruption

A series of studies addressed the particular risks of procurement procedures and their exposure to corruption. These studies identified especially exposed phases and established indicators for abuse, so-called “red flags”, or pointers towards bribery. The French Central Service for the Prevention of Corruption (*Service central de prévention de la corruption*), whose work is featured in a paper in this publication, has developed particular proficiency in identifying such sensitive areas.

In a study commissioned by the World Bank and the Inter American Development Bank, the Basel Institute on Governance identified the following critical stages in the procurement process:

- The *selection of consultants.* Frequently consultancy contracts fall below the threshold of competitive bidding, so that “friendly” consultants can be chosen.
- The *design and preparation of tender documents.* Calculations can be manipulated so as to result in the explosion of specific costs during the execution of the contract.
- The *actual bidding procedure.* One needs to distinguish in particular the risk factors for competitive bidding, restrictive competitive bidding, and direct acquisition. Even the rules of competitive bidding can be short-circuited by, for instance, the setting of a particularly brief timeframe, by insufficient publication, by biased design etc.
- The *decision phase.*
- Finally, one should not under-estimate risks in the actual execution phase, for example the risk of change orders.

Risk analyses allow for the identification of indicators, which are in turn essential stepping stones towards preventive rules.

Action by the OECD Working Group on Bribery in International Business Transactions

The OECD Working Group on Bribery in International Business Transactions (the Working Group) has already identified two directions for immediate action in its 1994 "Recommendation on Bribery in International Business Transactions": the improvement of standards for public procurement procedures, and the use of granting or refusing access to procurement as an incentive or a sanction related to corrupt behaviour.

In 1995 the Working Group held a Symposium to explore the issues further and invited other international organisations and multilateral development banks (MDBs) to share their experiences in developing rules on procurement. Based on the outcomes of this event, the Working Group decided to leave the actual development of standards on procurements to the MDBs and specialised organisations, *i.e.* WTO. Concerning aid-related procurement, the Working Group identified the OECD Development Assistance Committee (DAC) as the principal focal point.

The OECD Revised Recommendation of May 1997 broached the issue again, in paragraph VI. It focuses on three items.

Section i) refers to the then ongoing work of the WTO. This should be read in an open manner, as a reference to the work of international organisations and MDBs in general.

Section iii) picks up the work by the DAC, its 1996 Recommendation and its follow-up.

Section ii) is the Working Group's main focus: using debarment from public procurement as and additional sanction for active bribery of foreign public officials.

This must be regarded as part of a larger framework consisting of criminal and civil law sanctions as well as tax law and procurement sanctions, designed to increase the risk for companies of being caught in the act of trans-national commercial bribery.

Debarment

Debarment is therefore part of both the OECD sanctioning system against trans-national bribery and the follow-up and monitoring programme, where country implementation and application of the OECD instruments against corruption are discussed. However, the Working Group has found so far that the rules of debarment are applied by Member States in a rather inconsistent manner. In some countries, debarment is actually a criminal sanction that is imposed in addition to or as an alternative to fines for corruption. In other countries, debarment is an administrative sanction against corporations. In a third group, it is not an explicit sanction, but a matter of discretion for the procurement agencies.

The really difficult issue is whether countries are ready to deny access to their **own** companies in domestic procurement as a sanction of the bribery of **foreign** officials, which is among the actual goals of the 1997 OECD Revised Recommendation. So far, several countries have merely declared themselves ready to block foreign countries bribing in their sphere of influence.

Once one goes into the details, debarment issues become rather delicate, and so far little energy has been spent on these issues on an international level, despite the fact that the issues are decisive and that debarment could potentially ruin a competitor.

Let me merely mention a series of issues we have identified in the course of earlier seminars for further study during our work within the Working Group on Bribery with a view to increased harmonisation of approaches.[1]

Fundamental is the question of the basis on which companies are to be excluded: convictions or equivalents like pre-agreements? already on indictment or even simple suspicion?

What discretion do procurement agencies have on whether to open proceedings for debarment?

What are the determining factors for the severity of the sanctions, *i.e.*:

- What entity is to be debarred, the entire corporation or individual departments, subsidiaries etc.? For what length of time?
- Within which public entity (community, state, country)?
- If debarment is not merely an issue for discussion on a national level but supra-nationally, for example by an MDB (the World Bank) for all its aid-funded contracting, the issue of debarment definitely becomes a very serious weapon and needs to be applied with great care. One of the main issues is to guarantee fair procedure, especially as we are operating outside the traditional context of constitutional law and controls applicable in a national setting.

I am confident that the contributions in this volume are an important step towards the prevention of bribery in public procurement.

1. *Travaux préparatoires* for the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, International Trade Corruption Monitor (ITCM), 1999, f-10 69.

Chapter 2

Improving Integrity in Public Procurement:

The Role of Transparency and Accountability

by

Robert A. Burton*

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Public procurement is a central instrument to ensure an efficient management of public resources. Promoting good governance in public procurement, in particular through sound procurement regulations, clear ethical standards as well as budget transparency and control, is a key concern of the OECD Public Governance Committee.

Efforts to promote integrity in public procurement: The role of the OECD Public Governance Committee

OECD countries strongly acknowledged that globalisation and close interaction of the public and private sectors demand the update of values and standards to maintain integrity in the public service with the 1998 Recommendation on Improving Ethical Conduct in the Public Service. The Recommendation includes a set of Principles for Managing Ethics of the Public Service that highlight the importance of ensuring transparency in public decision-making and call for the definition of clear guidelines for interaction between the public and private sectors.

The Public Governance Committee also recognised in 2003 the importance of risks to good governance arising from conflicts between public officials' private interests and their public duties due to the increased interactions between the public and private sectors. The Guidelines on Managing Conflict of Interest – approved in the form of an OECD Recommendation – provide a comprehensive instrument for ensuring that the integrity of decision-making is not compromised by private interests, particularly for officials working in fields such as public procurement.

The 2004 Global Forum on Governance: Fighting Corruption and Promoting Integrity in Public Procurement took the process one step further by identifying the lack of transparency and accountability in public procurement as one of the major threats to the integrity of the procurement process. The Forum marked the launching of a crucial activity of the Public Governance Committee on how good governance principles, in particular transparency and accountability, can be applied in the field of public procurement to promote integrity and prevent corruption. The Expert Meeting on Integrity in Public Procurement in June 2005 identified risks and vulnerable areas for corruption at different stages of the public procurement process. Participants strongly endorsed the need to consider not only the bidding process, which is the traditional focus of international efforts, but also the phases of definition of needs and contract management that were considered at higher risk. In addition, the participants started mapping out good practices to successfully promote integrity, transparency and accountability, and to prevent corruption, in the public procurement process.

The experience and lessons learned from the United States acquisition system highlight key aspects of how good governance principles such as integrity, transparency and accountability could be applied in the field of public procurement.

Promoting integrity, transparency and accountability: The experience of the United States acquisition system

The United States' acquisition system aims at providing best value to its citizens through processes that are transparent and results-oriented.

Transparency

The government seeks to attract the participation of high-quality contractors in federal procurement through processes that are open and fair. There are a variety of ways in which transparency is promoted.

- A single, government-wide body of rules

Government-wide statutes (such as the Federal Property and Administrative Services Act) and regulations (most notably the Federal Acquisition Regulation, or "FAR") are designed to promote uniformity, so vendors can rely on a common set of rules regardless of the agency with which they wish to do business.

- Public rule-making process

Before rules become effective, they are generally published in the *Federal Register* for public comment and those comments are considered in the formulation of the final rule. The publication requirement applies to all rules that have a significant effect beyond the internal operating procedures of the agency or a significant cost or administrative impact on contactors. When a rule is finalised, agencies prepare a preamble that describes the public comments received and explains how concerns were addressed.

- Open access to contracting opportunities

As a general principle, statutes call for "full and open competition". This standard gives all responsible sources (*e.g.* those with adequate financial resources, satisfactory performance record and satisfactory record of integrity and business ethics) the opportunity to submit offers to perform government contracts. Exceptions to the requirement for competition are limited (*e.g.* there is only one responsible source or unusual and compelling urgency, disclosure would compromise national security).

Agencies must justify their decisions to forgo competition, *e.g.* they must: demonstrate that a proposed contractor's unique qualifications require use of an exception; identify market research efforts that support their conclusions; detail efforts made to ensure offers are solicited from as many potential sources as is practicable; and describe steps taken to ensure a fair and reasonable price. Exceptions must be approved – the larger the exception, the higher the level of the approving official.

Agencies are required to provide widespread notice on the Internet of contracting opportunities. Through "FedBizOpps", a one-stop customer-friendly Internet site, interested vendors can search for information on business opportunities in a variety of ways (*e.g.* via product, service, location, posting data). They can sign up to receive emails identifying opportunities of interest.

Accountability and integrity

Accountability

The processes are designed to hold agencies and their contractors accountable for results.

- Capital programming

For major capital acquisitions, agencies are required to prepare business cases to justify their budget requests. The cases must be reviewed in the agency by a multidisciplinary executive committee. This review process ensures that investments reflect the needs of all

stakeholders. In addition, contractors are required to implement earned value management, a performance measurement system used to assess the cost, schedule and performance status of the contract on a monthly basis. These steps enable agencies to avoid wasteful duplication of expenditure and identify projects at risk.

- Competitive sourcing

Agencies are asked to subject commercial activities performed by their federal employees to competition with the private sector (*i.e.* public-private competition) to determine which sector can provide the best overall value to taxpayers. Public-private competitions completed in fiscal year 2003 are expected to generate savings of USD 1.1 billion over the next 3-5 years.

- Performance-based service contracting

Agencies are expected to structure their contracts around desired solutions and levels of performance rather than processes that tell contractors how to do the work. This approach stimulates the creativity and initiative of the private sector, and can reduce the costs of contract administration.

- Record keeping and reporting

The US government maintains a central database of information on federal procurement actions to enable Congress, agencies, industry, and members of the public to evaluate results achieved from their acquisitions. Executive branch agencies issue a number of reports to keep Congress and the public informed of promising trends and areas in need of improvement.

Integrity

Numerous mechanisms are built into these processes to help prevent procurement officials and competing contractors from intentionally or inadvertently subverting fair competition.

Level playing field

- Rules require agencies to develop clear statements of work that describe scope, magnitude, and duration in a manner that reasonably enables a potential offeror to decide whether to request the solicitation and consider submitting an offer.
- Rules require that agencies base their award decisions on the factors specified in the solicitation.
- If an agency solicits sealed bids and intends to award without discussion a qualified bidder offering the lowest price for the good or service described in the solicitation, the agency must require submission by a uniform deadline and bids must be opened in public.
- If an agency undertakes a negotiated procurement – where it bargains with offerors and evaluates proposals on the basis of price, technical capability, and other quality considerations – the agency is bound by rules that govern how communications (discussions) are to occur and how offerors are eliminated from the competition.
- Agencies routinely debrief unsuccessful offerors (*e.g.* the agency identifies the significant weak or deficient factors) so the latter can understand why they did

not receive the contract award and make themselves more competitive for future work.

- Processes are provided for unsuccessful offerors to protest awards, either in the agency or at independent forums external to it (*e.g.* the Government Accountability Office, Court of Federal Claims). Protests may challenge government actions prior to award (*e.g.* the content of the government's solicitation) or after award (*e.g.* the government did not follow the evaluation methodology outlined in the solicitation).
- Contractors are permitted to file claims against the government when disputes arise over contract performance.

Reputable business partners

The government relies on a series of safeguards to ensure it is dealing with honest and reputable contractors.

- It only does business with responsible sources – those with a satisfactory performance record, financial resources, and satisfactory record of integrity and business ethics.
- Contractors who have established records of poor performance, unethical behaviour or other violations of law (*e.g.* of federal statutes) may be debarred or suspended, subject to procedures that ensure due process of law (*e.g.* generally, notice and an evidentiary hearing) prior to agencies taking disciplinary or exclusionary actions. Suspensions are usually for a period of one year or less. Most debarments are for three years, although some – such as for drug offences – may be for five years).
- Statutory ethics restrictions, known as "procurement integrity," impose restrictions on certain conduct:
  - Disclosing sensitive procurement information (*i.e*. contractor bid or proposal information or source selection information – such as bid prices, technical evaluation plans, etc.) during the procurement process.
  - Discussing employment with prospective contractors when participating personally and substantially in a federal procurement.
  - Accepting compensation from contractors for one year after the official either served in or performed certain functions (*e.g.* contracting officer) or personally made certain decisions (*e.g.* awarding contracts) in relation to a major contract (in excess of USD 10 million).

Policy challenges

Competing interests require policy officials to make concerted efforts to maintain an adequate level of transparency and accountability in the acquisition system.

Efficiency

A reduced acquisition workforce and a continuing need for evolving technologies require increased efficiency from our acquisition system. As a result, agencies encounter pressure to use more streamlined and less formal contracting practices, such as limited

competitions among a small number of pre-qualified contractors. Streamlined processes are critical and often favoured by commercial companies that are more likely to use these less formal practices in their own commercial dealings than full and open competition.

The challenge: Agencies must ensure these processes are used in a sound and strategic manner that achieves good value and maintains the public's confidence in the integrity of the procurement system. This requires policy officials to continually refine guidance, provide better training, and conduct programme reviews.

Addressing individual agency needs

The demands associated with fighting terrorism and other requirements have caused some agencies to think about pursuing agency-unique waivers from competition and other acquisition rules. Policy officials must weigh these considerations carefully in light of the flexibility already available to obtain cost-effective, quality performance.

The challenge: Agency-unique processes can increase the cost and complexity of doing business with the government and make it more difficult for the government to attract contractors that can produce the best results for taxpayers.

Chapter 3

Competition and Anti-Corruption Considerations in Public Procurement

by

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Before exploring the relationship between corruption on public procurement markets and anticompetitive practices, we should note that corruption does not occur only in public procurement markets but also in private procurement markets. For example, dealings of people in charge of building maintenance with electricians, elevator manufacturers, plumbers, etc. often give rise to favouritism and direct or indirect bribery. Similarly, business literature is replete with stories of procurement officers in business firms being bribed by suppliers.

Yet, in a number of countries there is a perception that corruption is a more important problem in public procurement than in private procurement. A number of reasons may explain this perception.

- First, public procurements tend to involve larger and more visible orders (*e.g.* hospitals, railways, planes, bridges, power plants) than private procurement markets. Thus, even if the frequency of corruption were the same in both types of procurement markets, its magnitude in financial terms on public procurement markets would seem to be more striking.

- Second, governments may have more complex "objective functions" than private parties awarding contracts through a tender process. Local governments, for example, may be particularly sensitive to political issues such as local employment, the promotion of regional firms, distributing work evenly among local suppliers etc. even if some of these objectives, because they are not based on technical or efficiency considerations, cannot always be explicitly acknowledged as criteria of choice in the design of the procurement markets or the selection of the bidders or of the winning bid. As a result, the way in which government procurements are awarded may seem to be less transparent than the way in which private contracts are awarded. This fuels the suspicion that corruption is more of a problem for public procurement markets than private procurement markets.

- Third, there is a suspicion, in some countries, that the allegedly low level of income of civil servants may prompt them to engage more frequently than private sector employees in corrupt practices to achieve a level of earnings similar to the private sector.

- Fourth, in many countries there is a special concern about the possibility of abuse of power by public offices holders. In these countries, public procurement markets are more closely scrutinised than private procurement markets. As a result, even if the level of corruption were the same in both types of markets, more cases of corruption would therefore be discovered in public procurement markets.

- Fifth, in many countries the ability of political parties (and elected officials) to raise political funds legally is severely restricted even though there are clear indications that the ability to survive political challenges crucially depends on the resources of political parties. Thus, there is a particular form of pressure on office holders to use the awarding of public contracts to secure economic favours (*e.g.* transportation, advertising, monetary donations, the building of facilities such as swimming pools, parking lots, etc.) which will enable them to stay in office.

- Lastly, one reason to focus on corruption in public procurements while paying comparatively less attention to corrupt practices on private procurement markets may simply be that there is a general feeling that governments have a particular responsibility to eradicate those practices on public procurement markets. They have the ability to do so through public policy means such as the enactment of particular rules and procedures for the design of public procurement markets whereas they have both fewer means and less responsibility to regulate private procurement markets.

Circumstances under which corruption can occur in the context of public procurement

There are two types of related situations in which corruption by public officials can thrive.

First, there is the situation in which a public official can allow or prevent an economic operator from exercising a profitable economic activity through the granting or the withholding of an authorisation. Second, there is the situation in which the public official can exercise discretion in the awarding of a lucrative contract. In both cases, there is a "principal-agent" problem. Whereas the awarding of the authorisation or the contract are supposed to be done in such a way as to maximise public welfare, the complexity of transactions makes it impossible for the end-users to award contracts directly and they have to go through an agent over whom they have limited control because of informational asymmetries.

For example, regarding public procurement markets, the body in charge of establishing the contract specifications, selecting the bidders and choosing the winning bid is frequently composed of appointed or elected procurement officers who act as intermediaries between the beneficiaries and the potential providers. There are a number of cases in which the end consumers (or taxpayers) have little ability to discuss the technical aspects of the particular contract objectives or to assess the respective qualities of different bids submitted or the reliability of the various bidders. The difficulty stakeholders have in exercising some control over the design and awarding of public procurement contracts, and thus the possibility for corruption, will be greater in cases where the service or the product which is the object of the contract is complex and/or has been designed to meet the specific needs of the demander. For example, the building of a road or a water distribution system, and more generally any type of public works, will have to take into account the specificity of the terrain involved. This terrain will necessarily be different from the terrain in another town and thus, aside from the difficulty of assessing the validity of the solutions presented by the bidders to meet the technical challenges they face, it may also be difficult to find price references for similar situations.

In such cases, there is a possibility for procurement officers or the members of the procurement commission to behave strategically, that is to design the contract, to select the bidders and award the contract in such a way that the winning bidder will not necessarily be the one who maximises the social benefits but the bidder who will maximise their own welfare (by offering the largest bribe) without this strategic behaviour being easily detected.

On the contrary, in cases where the procurement contract involves the provision of a standardised product (such as office desks, or chairs), it will be more difficult for procurement officers to behave strategically without being exposed and, generally there

will be less concern about the possibility of corruption. However, when such standardised products are technologically complex and/or have to be used in conjunction with or by a highly specialised service provider, the possibility of strategic behaviour on the part of a corrupt procurement officer (or of any person intervening in the procurement process) arises again. For example, the chief surgeon of a hospital may typically be able to designate the specific brand of prosthesis he or she wants the hospital to buy and sometimes the intermediary it wants the hospital to buy them from without anyone being in a position to control whether or not the choice is dictated by strategic considerations.

A different type of situation concerns the case in which a firm bidding for a public contract bribes another firm (a potential competitor) not to bid (or to deposit an artificially high bid). In such a case, the origin of the corruption is not a "principal-agent" problem but the desire of potential bidders to avoid competing with each other because competing would result in a lower level of profits for both of them.

Anticompetitive practices and corruption in public procurement

By definition, corruption in procurement markets involves a different process of allocation of contracts than would have been obtained through a competitive process. Corruption either leads to a situation where the contract is not awarded to the lowest bidder (or the bidder who has offered the best solution from qualitative and price standpoints) but rather to the firm who has offered a bribe (or the highest bribe) or to a situation in which there are fewer (true) bidders than would otherwise have been the case. In most cases, the end consumers will end up paying more than they would have without the bribe and/or will receive lower quality services. In this sense corruption in public procurement implies a distortion of the competitive process.

However, beyond this general consideration, corruption on procurement markets can lead to anticompetitive bid-rigging (one of the hard core anticompetitive practices which is illegal under all competition laws) and, as was mentioned previously, the attempt to eliminate competition on procurement market can lead to corruption. Thus corruption and anti-competitive practices can be highly complementary, even though they are sometimes thought of as substitutable (if a firm knows that its bid will win thanks to corruption it does not have to enter into a market sharing agreement with its competitors).

Anticompetitive bid-rigging can be the result of corruption in procurement markets

In cases where a potential bidder bribes a procurement officer, complementarily can exist between corruption and anticompetitive practices. This occurs in democratic countries and in countries that have a strictly enforced public procurement code.

In democratic countries, the political consequences of overt favouritism can be dire and corrupt elected officials are usually careful to hide their misbehaviour so as not to offer weapons that their political opponents could easily use against them. Furthermore, in countries that have public procurement codes designed to ensure that officials do not misuse public funds to which they have access, a controlling body is usually in charge of verifying the appropriateness of the procedures followed during the tender processes. In both instances, therefore corruption must remain hidden from view. One of the ways used by corrupt procurement officials to achieve this result is to ask the corrupting firm to ensure (through bid-rigging) that its bid will be the lowest bid, thus making the detection of the corruption more complex by the political opponents or the public procurement code enforcers.

One may ask why the other bidders, who know that they will not win the bid, agree to rig bids on a particular market so that their bids will appear clearly unattractive compared to the bid of the corrupt firm. Several scenarios are possible. First, it is possible that the corruptor will pay some bribe money to its competitors so as to make it worth their while to come up with uncompetitive bids. Second, it is also possible that the corrupt bid winner will subcontract part of the work to the losing bidders. Finally, at least in lines of business in which there is a high level of concentration and in which the same firms compete with each other on many tenders each year, there is the possibility of explicit or tacit exchange (*e.g.* "I will cover for you in this procurement market if you do the same for me in that market").

An attempt to eliminate competition on procurement markets can lead to corruption

A real life example will help us focus on this type of scenario. (This example is based on an article published in the Financial Times, Wednesday, May 21, 2003 and on further research by the author.)

In 1998 the government of the state of Sao Paulo decided to privatise Eletropaulo Metropolitana which was the largest electricity distribution company in Latin America with 5 million customers. It was the largest privatisation Latin America had ever seen. The Government of the State of Sao Paulo committed itself not to accept bids below USD 1.78 billion. It had been advised that the utility could bring several hundred million dollars more and one of the potential bidders had placed a maximum value of just less than USD 3 billion on Eletropaulo in a private study it conducted to decide whether or not to bid.

The Sao Paulo Government was eager to find firms which would have the ability to run a privatised public utility and, thus, only three bidders were allowed to participate in the auction:

- Enron, the US energy trader;
- a consortium, The Light Energy Consortium, whose four shareholders were AES, the large US energy group, Electricité de France, Houston Industries and CSN, a Brazilian steel company; and
- VBC, a Brazilian group.

The Sao Paulo stock exchange was to be closed on April 15, 1998 during the time of the auction.The night before the auction took place AES, one of the Light Energy consortium shareholders approached Enron. The offer AES made Enron was simple. In return for not bidding, Enron would build a 1,500 megawatt power plant with AES to supply Eletropaulo; it would be lead developer and operate the power plant, pulling in fees for both; it would also provide all the fuel, which it would obtain through its stake in the Bolivia-Brazil gas pipeline. Negotiations lasted until 4 a.m. on April 15th and an agreement was finally reached a few hours before the auction.

On the morning of April 15th, armed with two envelopes – one offering USD 1.78 billion and another for an extra USD 500 million – executives from the Light Energy consortium arrived at the Sao Paulo stock exchange prepared to bid for a stake in Eletropaulo Metropolitana. Seconds before the three-minute bidding window elapsed, it became apparent that Enron and VBC were onlookers. Per his instructions in the absence of another bid, Light's broker handed in the first envelope, thereby securing Eletropaulo at the minimum price. It was a disaster for the Brazilian government. The jewel in the

crown of energy assets for sale that year, Eletropaulo had been expected to bring several hundred million dollars above the minimum estimate.

Had Enron or VBC deposited a bid, the Light Energy consortium broker would have deposited the second envelope with an offer of an extra USD 500 million. Thus the Government of Sao Paulo lost at least USD 500 million. The upper estimate of the direct loss incurred by Brazil is USD 1 billion (the difference between the bid deposited by the Light Energy Consortium (USD 1.78 billion) and the maximum value of Eletropaulo estimated by Enron when it was considering bidding. According to their agreement, both the Light Energy consortium and Enron stood to gain from the bid-rigging. Light Energy would save USD 500 million in the bidding. It would have to grant a contract to Enron for the production of electricity but part of the increase in the cost of electricity due to the contract would, presumably, be passed on to consumers. Thus part of Enron's profits would be an additional (indirect) cost of the bid-rigging. Estimates of the value of the contract for Enron by former employees range from USD 200 million to USD 800 million. A former senior Enron employee said that everyone was very excited about what had happened, but that there was caution, too, "…it was made clear that we shouldn't advertise what had happened". Enron executives were particularly happy because, unknown to AES, before being approached by EAS, Enron senior management had decided not to bid for Eletropaulo.

In 1999, another Brazilian energy power generation company (CESP-TIETE) was privatised. Three companies were pre-qualified and allowed to bid. The three were Enron, AES, and VBC. Only AES and VBC placed bids and AES was the winner. The same kind of practice as the one describing the privatisation of Eletropaulo is suspected of having taken place again.

Fighting corruption and improving transparency in public procurement

The issue of whether increasing transparency in public procurement markets will help fight corruption and eliminate anticompetitive practices deserves some attention.

It is clear that improving transparency of the procedure by which the contract will be designed, the bidders will be chosen and the winner will be selected can both diminish the ability of the public body in charge of organising the procurement market to exercise discretion and allow the controlling bodies to monitor the process more easily. Thus increased transparency is likely to diminish corruption.

However some care must be taken that increasing transparency in order to decrease the possibility for public officials to engage in corrupt practice does not increase the scope for anticompetitive practices and for the corruption among the bidders themselves.

This issue was hotly debated during the preliminary discussions on the possible amendment of the French public procurement code (Code des Marchés Publics). One idea which emerged was that in order to make public procurement officials more accountable (and supposedly less likely to engage in corrupt practices) the results of all the bids received for each public tender (rather than the winning bid only) should be made public. Thanks to this enhanced transparency the stakeholders would be in a better position to monitor the process and to verify that the selection of the winner had been fair. Interestingly enough this proposal was supported by most of the business community.

However, the competition authority (*Conseil de la Concurrence*) had strong reservations about the wisdom of such a measure. In an opinion given to the Minister for Economic Affairs, the *Conseil* remarked that such transparency would allow bidding

firms to monitor precisely the behaviour of their competitors. In cases of attempted bid-rigging it would thus discourage would-be cheaters from placing competitive bids for fear of being found out even if they did not win the order and for fear that this would facilitate reprisals if they were in competition with the same firms on future procurement markets. Furthermore, even in the absence of bid-rigging the sheer fact that, tender after tender, bidding firms would know how their competitors behaved would facilitate tacit agreement among them. Part of the reaction of the *Conseil* is explained by the fact that, in France, as may also be true in a number of European countries, there is a fairly high degree of concentration (at least when it comes to firms able to bid for very large projects) in the building and public works sectors. As a result, firms find themselves repeatedly in the position of having to bid against the same competitors.

It is well known that if perfect information is a condition leading to efficiency in competitive markets, it is also true that on oligopolistic markets (and the number of bidders on most public procurement market is limited) transparency can facilitate tacit collusion.

One of the ways to overcome this difficulty is to ensure that very detailed information on the bidders and on their bids is available to the body who is in charge of controlling the bureaucracy (or political bodies) organizing public tender offers while keeping as much of this information as possible from the bidders themselves (and therefore not disseminating it to the general public). But this may be a challenge in countries where such controlling bodies have limited resources to exercise their mission or have limited credibility and in which an important function of (informal) control of public officials rests with the general public.

Conclusion

These few remarks on the relationship between anticompetitive practices and corruption on public procurement markets lead to some suggestions on how to facilitate the fight against corruption on public procurement markets.

It is clear that having good laws for the financing of political parties, high ethical standards in the civil service, low concentration of suppliers, a satisfactory level of resources and technical expertise as well as transparent information for the controlling bodies of civil servants or elected officials in charge of public procurement, stronger antitrust and anti-corruption laws will all contribute to reducing the importance of corruption in public procurements.

But an additional suggestion can be offered. It is noteworthy that in many countries the enforcement of antitrust or competition laws (usually entrusted to the competition authority) is entirely unrelated to the enforcement of anti-corruption statutes (usually entrusted to the judiciary or anti-corruption body). The complementarity between corruption and anticompetitive practices noted earlier suggests that this lack of coordination unnecessarily diminishes the deterrent effect of both competition law and anti-corruption law by decreasing the probability that objectionable conduct will be identified and by making the sanction of complementary practices of corruption and bid-rigging more lenient than it could be. Systematic exchange of information between the two enforcement agencies and joint investigations are therefore highly recommended. In particular it would seem wise to systematically open a competition investigation on procurement markets for which evidence of corruption has been found.

Chapter 4

Development Assistance Cooperation:

How Building Procurement Capacities Can Help Improve Integrity

by

Richard Manning*

* Chair of the OECD Development Assistance Committee

Procurement, in any country, is one of the areas most vulnerable to corruption. Procurement involves a high degree of discretion in decision-making both in the nature of the goods or services purchased and also on the choice of contractor. Interaction between the public sector and the business sector often involves large sums of cash, and proves difficult to monitor, especially in decentralised systems where procurement takes place in many areas of the government.

Development Assistance Committee (DAC) members[1] have been working with developing countries over the last decade both to strengthen procurement systems and to fight corruption. These efforts should be seen as mutually reinforcing and must be taken forward in tandem. I am pleased that this was one of the key messages conveyed at the 2004 OECD Global Forum on Procurement. This event was a timely reminder of the importance of safeguarding procurement from corruption, particularly as the international development community in 2005 gears up for significant increases in aid, possibly an additional USD 50 billion per year by 2010 and beyond.

Corruption and Procurement: a central concern for members of the Development Assistance Committee

In 1996, members of the DAC agreed to a formal DAC Recommendation on Aid Funded Procurement[2] designed to help safeguard aid-funded procurement from corruption. As part of this Recommendation, DAC members collectively agreed to introduce anti-corruption provisions in bilateral aid-funded procurement carried out by DAC members themselves. A key element of this was to include a standard clause enabling aid-funded contracts issued by DAC members to be cancelled if there was evidence of corrupt practice. The anti-corruption provision of the Recommendation was adopted by all DAC donors and was later integrated into the 1997 OECD Revised Recommendation of the Council on Combating Bribery in International Business Transactions. However, the Recommendation did not apply to procurement carried out by developing countries themselves, whether or not financed by aid. With the aim of maintaining the momentum on improving such procurement, developing countries, bilateral and multilateral donors have in the last few years worked together through a Round Table process to develop a set of tools and good practices to improve procurement systems and help strengthening integrity. In December 2004, Round Table participants adopted the "Johannesburg Declaration", which confirmed their commitment to implement these good practices, which include a DAC Good Practice Paper on Procurement Capacity Development[3] which is intended to reinforce and strengthen efforts by developing countries to develop sustainable capacity. The guidance includes tools for assessment and comparison using baseline standards of quality for procurement systems. The assessment tool establishes baseline standards for well-designed procurement systems and highlights that effective mechanisms for ensuring transparency and fighting corruption constitute one of the core pillars of a good procurement system.

Some key messages from the Global Forum

Most recently, as part of the 2004 Global Forum on Procurement, the Development Assistance Committee organised a workshop[4] aimed at assessing the effectiveness of different donor approaches to safeguard aid-funded procurement from corruption and bribery. The most important message at this event—from donors and partner countries alike—is that anti-corruption efforts and efforts to strengthen procurement are complementary and must be approached in tandem, given the important synergies.

Donors and partners highlighted a set of measures to safeguard procurement from corruption. These included:

- Preventive measures, such as efforts to improve the skills and awareness of personnel assigned to carry out procurement within public institutions so they can better detect situations likely to involve corruption. The use of information technology can help secure procedures and reduce the risk of manipulating documents, for example.
- Punitive measures, such as the exclusion of individuals or companies that have committed corrupt or fraudulent acts from future bidding opportunities.
- Fireproofing or protecting procurement processes by assessing needs thoroughly and carefully designing a flexible strategic plan that includes close monitoring – in countries with weak procurement systems and endemic corruption until specific measures have been implemented;
- Strengthening the full range of institutions and organisations including the business community, involved in local procurement delegated to partners, such as in community level projects.
- Harmonising donor systems and developing common approaches such as Sector Wide Approaches.

Action on these specific issues can significantly improve the integrity of procurement systems. However, they need to be accompanied by other reforms, including changes in the way donors support partner governments.

The DAC's most recent efforts to address procurement and corruption in the context of the aid effectiveness agenda

One of these changes is already underway. Donor-driven perspectives have given way to approaches where donors support developing countries' own anti-corruption work and back their efforts to strengthen their own procurement capacities . This important message has been set out in the 2005 Paris Declaration on Aid Effectiveness.[5] This Declaration sets forth a clear agreement that setting development objectives—including efficient and accountable procurement systems—is the primary responsibility of developing countries, with donors playing a supportive role. Specifically, joint commitments undertaken by partner countries and donors call for sufficient resources to support and sustain medium- and long-term procurement reforms and capacity development.

Secondly, current efforts to strengthen procurement systems must be complemented by stronger collective donor measures to help fight corruption and develop capacity at country level. The DAC's most recent anti-corruption efforts are being developed by its Network on Governance (GOVNET) to embrace the key areas and activities where donors should work together to ensure coherent support to country-led anti-corruption strategies and to ensure that aid programmes do not foster corruption. The GOVNET is currently working on *Principles for Donor Action in Anti-Corruption* which highlight in particular the need to strengthen domestic demand for accountability and transparency from parliaments, civil society, and the media. It is hoped that the Principles become a new framework for collective action for donors. Improvements in donor coordination at the field level will be crucial to the success of this framework.

Finally, DAC members' efforts to support recipient countries' capacity are important for the long-term success of procurement systems. The DAC's most recent work on capacity, "*Living Up to the Capacity Challenge: Lessons and Good Practices*"[6] offers donors general guidance on this issue. One important message that is particularly relevant to those working on procurement is that the way that staff are paid and incentivised is a powerful instrument for achieving and sustaining the capacity of institutions. In the long-term, governments need help to become competitive employers of their skilled people; in the short-term, enhanced compensation arrangements agreed between donors and partner governments are preferable to salary competition among donors to tempt local staff to work for "their" projects.

Notes

1 Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States, Commission of the European Communities.

2 DCD/DAC(96)11/FINAL.

3 DCD/DAC/EFF(2004)15. Additional DAC products include a Strategic Framework for Mainstreaming and Strengthening Public Procurement and a set of Benchmarking, Monitoring and Evaluation tools.

4 Workshop 5: *Development assistance cooperation: How building procurement capacities can help improve integrity* , OECD Global Forum on Fighting Corruption and promoting integrity in public procurement (November 2004).

5 DCD/DAC/EFF(2005)1/FINAL; The Paris Declaration on Aid Effectiveness was endorsed on 2 March 2005at the High Level Forum on Aid Effectiveness, by Ministers, Heads of Aid Agencies and other Senior Officials representing some 60 partner countries and more than 50 multilateral and bilateral development institutions.

6 DCD/DAC/GOVNET(2005)5, Good Practice Paper on Capacity Development.

Part II

Promoting Integrity Through Effective Transparency and Accountability Mechanisms

This part provides an overview of the discussions that took place in two forum workshops, ***Improving transparency in public procurement*** and ***Ensuring accountability: Designing and controlling sound procurement procedures***. The main findings outline the most prominent results of both discussions and written contributions to the workshops. They are followed by a series of papers prepared by workshop speakers and the OECD secretariat. János Bertók and Élodie Beth, under the supervision of Christian Vergez, of the Innovation and Integrity Division of the OECD Directorate for Public Governance and Territorial Development, were responsible for the organisation of these two workshops and reviewed this part of the publication.

Part II.A

Improving Transparency in Public Procurement

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Chapter 10	Republic of Korea: The Potential of E-Procurement Kyung-Soo Choi Administrator, Public Procurement Service, Republic of Korea
Chapter 11	Mexico: Lessons Learned in Promoting Transparency Roberto Anaya Undersecretary, Ministry of Public Administration, Mexico

Chapter 5

Main Findings of the Forum Workshop on "Improving Transparency in Public Procurement"

by

Élodie Beth*

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Introduction

This workshop reviewed practices and emerging standards to promote transparency in public procurement. The three major stakeholders involved in public procurement – elected officials, public procurement officers and contractors – reached a consensus on the need to address grey zones and opportunities for improperly influencing public decision-making arising from the lack of transparency and accountability.

Transparency was recognised as one of the most effective deterrents to corruption and a pre-condition for ensuring public officials' accountability. Participants explored innovative approaches and conditions for successfully promoting integrity in public procurement through transparency and accountability mechanisms, not only in the bidding process but also in the definition of needs and contract management. They indicated particular interest in the potential of new information and communication technologies to standardise processes, increase their transparency, improve access to markets, and promote integrity in public bidding.

However, the discussions emphasised that transparency and accountability in public procurement must be reconciled with other imperatives, such as providing guarantees for fair competition and ensuring an efficient management of public resources. The OECD was encouraged to take the lead in defining an adequate framework for using information in public procurement by looking more specifically at the different dimensions of transparency, in particular what type of information should be released, to whom and at what stage of the public procurement process.

Grey zones, bias and corruption in public procurement

Public procurement is a business process embedded within a political system. Governments are increasingly judged on the quality of governance provided, in particular on how transparency, integrity and accountability are ensured in the public procurement process.

Procurement regulations provide a framework for ensuring transparency in public procurement. But regulations quickly become outdated and can be easily circumvented. Therefore it is crucial to pro-actively identify the grey zones in the public procurement process, thus anticipating opportunities for improperly influencing public decision-making in public procurement. Forum participants identified the most critical grey zones that could undermine the integrity of the public procurement process: information asymmetry, contacts and informal networks, conflicts of interests of public officials, lack of accountability of public officials and contractors, and political financing.

Information asymmetry

The integrity of public procurement can be undermined by the discretionary power of a public procurement agent or by a bidder who holds information that is not available to the government. This information asymmetry may, where the interests diverge, allow for exploitation. While the government aims to ensure satisfactory quality and service at a reasonable price, the public agent who holds information related to the process and the bidders might be tempted to overspend in order to avoid budget reduction. Similarly, a public procurement agent who is in charge of defining the specifications of the bidding might have less knowledge of the market than suppliers (*e.g.* technical solutions, cost, average price, etc.). Consequently, a private firm might be asked to advise public

institutions on technical aspects of tender specifications, even if the firm is among the competitors for the contract. This represents an opportunity to influence the specifications in a direction that could benefit certain market players or the firm itself.

Contacts, informal networks and collusion

The rules for contact and communication in public procurement are also particularly exposed to violation. Contacts and informal networks are used in public procurement, not only to obtain information about tender requirements and procedures, but also to influence the outcome of the tender procedures themselves. A specific form of informal network between private contractors is the collusion between bidders, which refers to the co-ordination of firms' competitive behaviour that can result in a price rise, restricted output and higher profits for colluding companies.

In cases of inappropriate use of informal networks or collusion, early contact is needed to establish a trustful relationship so as to secure an unbiased outcome, for instance influencing specifications or selection criteria that discourage companies from participating and disqualify them on formal grounds. Contacts and informal networks can also facilitate payments to ensure that certain interests are favoured during the tender.

Conflict of interest on the part of public officials

Public procurement, which is at the interface of the public and private sectors, is an area particularly vulnerable to conflict between public officials' duties and their private interests. Conflict of interest arises when public officials' decisions during the public procurement are influenced by their private interests. For instance, common sources of bias in public decision-making include financial interests, family relationships, and post employment. If not adequately identified and managed, these conflict-of-interest situations provide opportunities for public officials to take advantage of their public position for their personal benefit.

Lack of accountability

More generally, lack of accountability in public procurement creates a fertile ground for malpractices and corruption. For instance, bidding organisations often are not held accountable for misbehaviour, whether in the bidding process (*e.g.* in the case of misinformation) or in the contract management phase (*e.g.* for cost overrun, faulty design, etc.). Similarly, public officials might be tempted to order excess quantities of an item that will be diverted later for personal use if there is no effective control mechanism on public procurement needs and expenses. This topic is explored in more depth in the following section on "Ensuring accountability: Designing and controlling sound procurement procedures".

Political financing

In addition to public procurement officers or bidders, elected politicians might also be tempted to use their influence improperly to secure a biased outcome in the procurement process. Many countries have experienced malpractice in public procurement linked to party and electoral campaigns. For instance, key elected officials might use their influence to favour a specific firm in the bidding process on the condition that the firm provides substantial funding for their political campaign.

Ensuring transparency in public procurement

There was consensus that transparency is one the most effective deterrents to corruption in public procurement, since it helps to identify and manage grey zones and risk areas for corruption. Participants pointed out that public information encompasses not only general laws, regulations and procedures on public procurement but also the information related to the bidding opportunity, in particular the method for tendering, specifications, selection criteria, award decision and reasons why bidders were not selected, as well as the disclosure of specific private interests of public officials.

Conditions for transparency to be an effective tool

Transparency was recognised as a pre-condition to allow different stakeholders to exercise scrutiny over public officials' and contractors' decisions and performance, thereby minimising their discretionary power. The Forum discussions highlighted the importance of providing public procurement officials, contractors as well as civil society, with public information that is accessible, consistent and objective in order to create an effective system of checks and balances. Public information should be:

- Accessible, *i.e.* understandable (*e.g.* clear specifications), timely (*e.g.* defining reasonable deadlines for submitting the bid; ensuring that the procedure for contesting the decision is reactive) and provided in a structured manner (*e.g.* establishing a single entry point for procurement);
- Consistent, *i.e.* the same rules apply for all bidders (*e.g.* a single set of regulations through a centralised database) at the different stages of the public procurement process (*e.g.* making sure that contract terms cannot be altered after adjudication, publicising information related to the bidding opportunity, the tender and the ensuing contract);
- Objective, *i.e.* a competitive environment for bidders is fostered by allowing the largest number of participants in the bidding process (*e.g.* reasonable conditions to participate) and by ensuring that the public procurement process is based on objectively measured factors (*e.g.* through the involvement of stakeholders in the definition of specifications) and is not influenced by specific interests (*e.g.* rotation of public procurement officials).

Innovative approaches: potential and limits of e-procurement

A key objective of the workshop was to explore innovative approaches and conditions for successfully promoting integrity in public procurement. Discussants recognised new information and communication technologies as a major tool to standardise processes, increase their transparency and promote integrity and prevent corruption in public procurement. The Mexican government highlighted the importance of Compranet, the electronic system for government procurement, in the government strategy to increase transparency of government actions, which was a key pillar of the Presidential Good Government Agenda.

E-procurement systems have in recent years demonstrated their benefits in terms of transparency, accountability and access by bringing information together through processes, simplifying access (*e.g.* payment through purchase cards) and reducing barriers to entry (*e.g.* one-time registration). An integrated and centralised bidding system, such as the FedBizOpps system in the United States and Tenders.net in Australia and New

Zealand, allows a more consistent application of public procurement rules at different phases of the public procurement process. Potential suppliers are provided with standardised and real-time information, which reduces the need for informal contacts between public officials and contractors.

It was also recognised that e-procurement improves efficiency in mass processing of public administration operations by reducing the cost of data collection and transmission, provision of information and communication. Furthermore, it allows public administrations to develop a better understanding of the public procurement process, its products, prices and main competitors, for instance through the development of an on-line catalogue. Workshop discussants expressed particular interest in using this institutional memory to identify suppliers with a bad performance record or which have used corrupt practices in the past. More generally, e-procurement helps verify that procurement takes place according to the "rules of the game" (*e.g.* by stocking information related to multiple bidding opportunities) and tracks deviations from normal practice (*e.g.* through an on-line evaluation by the general public).

It is important to note that e-procurement is not a "magic bullet". In order to harness the full potential of e-procurement, the basic conditions for implementation need to be ensured, *e.g.* through capacity-building, guidelines and training, as well as political commitment to make change happen. Furthermore, e-procurement can only be an effective tool for transparency if it is integrated into a broader corruption-prevention strategy. For instance, the recent shift in Korea from a traditional audit approach to a more systematic approach to corruption prevention in public procurement has been supported by complementary strategies including the adoption of international rules, the promotion of e-procurement and training, and incentives for change management.

Balancing transparency with other imperatives

The discussions emphasised that transparency at any price can have counter-productive effects and should be balanced with other imperatives, in particular competition, *i.e.* allowing the largest number of firms to take part in the public procurement process, and efficiency, *i.e.* providing satisfactory quality, price and service within a timely delivery schedule.

For instance, public procurement agencies might encounter pressures to use more streamlined and less formal contracting practices, such as limited competition among a small number of pre-qualified contractors in order to accelerate the process. A balance is to be found between providing efficient processes that achieve good value and maintaining public confidence in the integrity of the procurement system.

Increasing transparency might give scope for anti-competitive practices, leading in some cases to corruption among bidders themselves. A controversial practice is, for instance, the release of information on all bidders after the award of the public procurement contract that might help bidding firms monitor the behaviour of their competitors. In the context of an oligopolistic market, the number of bidders often being limited, this facilitates tacit agreement among firms for future bids. This phenomenon is discussed in detail in Part I, Chapter 4 on Competition and Anti-corruption Considerations in Public Procurement.

Participants expressed the need to define an adequate framework for providing information without harming competition or efficiency, and began to explore the different

dimensions of transparency, in particular: what type of information should be released, to whom and at what stage of the public procurement process.

What information?

OECD governments make a distinction in the use of different types of information: public information available in the public arena; commercially sensitive information, *i.e.* the know-how and technical capacity included in the bidding proposals, and information related to the privacy of public and private actors in the procurement process.

To whom should the system be transparent?

A crucial question in this context is how to strike a balance between the information needs of all stakeholders – public officials, private sector representatives and civil society – in the procurement process. Public officials in charge of the public procurement process will benefit from the widest access to information on public procurement regulations, on the specific bidding opportunity and on the record of performance and integrity of the different contractors. This access is essential to allow them to make a decision in the public procurement award.

The more bidders know about governments' requirements and the environment in which the system operates, the better they can design a suitable solution, which contributes to a more efficient management of public resources. However, transparency is a government concept, not necessarily a commercial practice. The private sector participant has an interest in the protection of commercial information in order to preserve the fairness of the competition. For instance, commercially sensitive information such as the technical content of a bid cannot be released to competitors.

Civil society has an interest in expenditures made through the public procurement system being economical, transparent and fair. Public officials are therefore expected to disclose all public information related to the bidding opportunity, to allow scrutiny by business and civil society at the different stages of the process. In addition, early and open disclosure by procurement officials of their private interests allows the identification and the prevention of conflicts of interest that might bias the fairness of the process.

At what stage?

Discussions also emphasised that the disclosure of information should be differentiated depending on the stage of the public procurement process, *i.e.* the identification of needs, the preparation for bidding, the bidding process, the award of contract or the contract management. Providing information on the public procurement process can be seen as positive for competition since it is likely to attract more competitors, which reduces the price and improves the quality of services provided to society. However, information might be harmful for competition if it is disclosed too early in the process. For instance, contractors who are informed about other firms competing for the public procurement during the submission of bids might be tempted to collude with them in order to secure the outcome of the process. Yet releasing information about the winning bid after the award of the contract will allow firms to contest the award decision, which is one of the guarantees of the fairness of the procedure.

Chapter 6

Grey Zones and Corruption in Public Procurement:

Issues for Consideration

by

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Fair competition and equal treatment of bidders are fundamental concerns behind 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, but offences can still be categorised in two groups:

i) Hidden violations of procurement rules – it looks 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 chapter 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 with 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 yield to a bribe, perhaps resulting in the construction of buildings that are not earthquake-proof, the use of consultants unable to advise and roads not solid enough to bear the ordinary traffic. 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 over health and education projects. In countries where corruption is endemic, rent-seeking becomes a serious issue affecting most aspects of public life and undermining general confidence and respect for bureaucracy, politicians, formal laws and regulations.

Corruption comes in the form 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 compels us to use alternative terms when debating the issue, such as undue business practices, bid rigging, pre-selection or pre-determination of contracts, low-quality business climate, irregular trot, connections, extra legal activities, etc.

Corruption is more common in some geographical areas than in others and more widespread in certain industries. Although the risk of corruption is present in many bureaucratic or governmental assignments, public procurement is probably the most exposed activity. This challenge was a main topic in a survey I conducted among Norwegian business leaders (Søreide, 2006) with helpful assistance from the Confederation of Norwegian Business and Industry (NHO). Eighty-two 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 throughout this chapter, 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 these have a job-related aspect like business excursions and tickets to events where also job contacts are invited. Drawing the line between unethical inducements and acceptable practices can be difficult, particularly as the potential for being influenced, for instance by a ticket to a world championship or a diplomatic visit to the United States, varies among clients and among 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% said that they offer valuable tickets to clients and 36% offered excursions; such practices are clearly more common in sectors perceived to be among the more exposed to corruption.[2] Still, these sectors also include firms with a clear policy never to offer clients gifts or excursions.

The survey aimed at clarifying the meaning of gifts in this setting. During interviews it was made clear that gifts or "bribes" requested can be very small, even 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. Even so, another survey, conducted by PriceWaterhouseCoopers, also this one in Norway, found that gifts of rather small value create bond between business partners that is able to influence the outcome of tender procedures (PWC, 1999)

Similar to marketing strategies, contact at an early stage is often a prerequisite for participation in business. Two-thirds of the respondents, with a majority among firms facing high competitive pressure in their main markets, considered 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 characterise a healthy business environment. There is generally a stronger reason to suspect corruption when early-stage contact is facilitated by middlemen.

Another grey-zone area of public procurement that is particularly vulnerable to violations is the rules of contact and communication. 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. Almost half the responding firms, 49%, said that it is common to negotiate all through the tender procedure. Just one-fifth of these

respondents claimed that relevant communication usually is copied to all tender participants. The tendency to negotiate all through the tender appeared 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. However, these are aspects that will also make it easier to cover corruption. The new rules recognise 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). Nevertheless, 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. In fact, the information is sometimes presented in a way that makes the firm unable to prevent being informed.

Technical consultation, bid rigging and pre-selection

Due to their high expertise, private firms are often asked to advise clients/public institutions on technical parts of tender specifications, even if those firms are among the competitors for the contract. This consultative service will in some cases represent an opportunity to influence the specifications in a direction that benefits the firm itself, or a firm that it co-operates with. Thirty-three per cent of the survey respondents were frequently "able to influence or asked to advise clients on tender specifications." Forty-one per cent found that tender specifications often "fit with the offer of one specific company", a result that clearly indicates pre-selection of contractor. 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 subcontractors use, and smaller firms can have incentives to influence complex contracts. However, the problem of pre-selection of contracts applies to public contracts of all sizes; small and medium-sized firms are, according to the survey results, just as exposed as large firms. Where differences do appear is among business sectors. Pre-selection seems to be more common in telecoms/IT, construction and oil, gas and power transmission, sectors that are considered exposed to corruption.

Political pressure

A considerable share of the survey respondents were frustrated about political influence on international tenders. Thirty-two per cent frequently found that a "competitor had won a contract with the help of political pressure"; 47% never or seldom experienced this problem. The pressure can take 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 on procurement contracts is destructive because it reduces the prospect of coming out of the tender procedure with the outcome that is 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.[3] However, the local welfare implication of such pressure is, of course, independent of the ties between the bidding foreign firm and its own government, and even without such a payment it resembles corruption. The client/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).

Quid pro quo is a different form of political pressure, still connected to international tenders, but now instigated by local political authorities. It refers to a reciprocal exchange in which the chosen firm provides benefits for local governments and their constituents, a practice that is not uncommon when the tenderers are large firms. Although it can be unclear what the content of the expected quid pro quo should be, the firms might promise to build a school or infrastructure, or to use local human resources, to demonstrate that they will operate responsibly in the local society. The relevant question is whether these forms of social responsibility and the inclusion of local contents in the contracts, is a form of bribery since it may induce a government to choose a particular bidder. Such suspicions are in some cases justified, and local content is able to cover corrupt transactions (Bray, 2005). However, the same local content can be demanded from the chosen bidder, regardless of which firm this is. And, a benefit to the local society is not supposed to privately profit the person in charge of the contract procedures. While the development implications of local content in business contracts vary a great deal (Heum et al., 2003), it is important not to lump this practice together with the criminal act of bribery.

New rules and the risk of corruption

The risk of corruption can be reduced, if 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 may also be more likely to apply unethical business practices (Søreide, 2006). The link between competition and bribery 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 thereby change the industrial organisation. Improved 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.[4] To measure this kind of problem it is important to consider the above-mentioned 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 has regularly been overestimated. Whereas 55% of the survey respondents did not think tender rules could prevent corruption, only six per cent considered them 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 for procurement reform. Reduced corruption has repeatedly been considered a side-effect of new and better rules. The World Trade Organisation 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, p. 38).[5] 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.

Notes

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).

2 See Transparency International's Bribe Payers Index for an overview of sectors that are perceived to be among the more exposed to corruption.

3 The pressure can also be a threat of 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.

4 Corruption facilitates tacit collusion because it reduces the participants' incentive to cheat. With an honest public official, cheating means offering a lower price than the cartel and thereby providing the firm with the short-term gain of winning the specific contract. When the public official is corrupt, on the other hand, the cheater initiates 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).

5 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 Web site.

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Chapter 7

Bulgaria, Czech Republic, Romania and Slovenia:

The Use Of Contacts and Informal Networks in Public Procurement

by

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Introduction

A number of studies on corruption carried out in East Central Europe and the Balkans during the past few years indicate that corruption levels are high in this region. There is also some evidence to the effect that corruption has increased following the collapse of communism and the introduction of the market[1] and that it is still on the rise. [2] Measures aimed at reducing corruption in EU applicant states introduced as part of the "acquis", appear to have had a limited impact not only in the new EU member states but also in the EU applicant states Bulgaria and Romania.[3]

Although the new EU member states, Bulgaria and Romania have introduced new and comprehensive legislation on public procurement in recent years, corruption in procurement remains a serious problem – and one for which it is proving difficult to find adequate solutions. There are of course a number of reasons for this[4], all of which act as brakes on anti-corruption reform. The major problem, however, seems to be that measures aimed at reducing corruption not only in public procurement but also elsewhere, have failed to address what is sometimes referred to as a "culture of informality", left over from communism. According to Ledeneva "it is not that the components of the rule of law are absent. Rather, the ability of the rule of law to function coherently has been subverted by a powerful set of practices that has evolved organically in the post-communist milieu." [5]

This chapter offers examples of how that "culture of informality" manifests itself in public procurement – more specifically, of how contacts and informal networks are used to influence the outcome of public tenders – presenting preliminary findings from 120 in-depth interviews with business representatives and public procurement officials in Prague, Ljubljana, Sofia and Bucharest during the winter 2003/04. The interviews[6] were carried out as part of a three-year project investigating how the culture of informality manifests itself not just in public procurement, but also in political party funding, lobbying and the judiciary in the Czech Republic, Slovenia, Bulgaria and Romania. The project, which is funded by the Norwegian Council of Research, is carried out by the Norwegian Institute of Urban and Regional Research in collaboration with Centre for Social and Economic Strategies at Charles University/GfK-Prague (Czech Republic), University of Maribor/CATI (Slovenia), Vitosha Research (Bulgaria) and Romanian Academic Society/Gallup (Romania).[7]

Contacts, informal cultures and informal networks

Given the large sums of money involved in public procurement, it is not surprising that a number of individuals and groups have vested interests in promoting certain outcomes with regard to public tenders. There are many ways in which this can be done. Businesses may submit a well-prepared bid for the tender and hope that the bid will be successful. Or they may try to ensure a favourable outcome by contacting public procurement officials themselves – to obtain relevant and publicly available information, or to obtain classified information, or to try to influence the outcome of the tender to their advantage. They could also approach the officials through somebody else – *i.e.* through a contact. The contact may know the official(s) personally and/or be better able to exert influence on the official than the person requesting the assistance. Another option would be to join forces with other people (business people as well as people from other professions) with whom they have shared interests by joining an already existing or forming a new group or network, and try to promote their interests through these.

A previous study conducted by Miller, Grødeland and Koshechkina[8] revealed that the use of contacts in local government in the former Soviet Union and East Central Europe is widespread. We have no reason to believe that this use is any less common in central administration. It also seems reasonable to assume that people sharing the same interests join forces to promote these interests. In west European countries formal networks have become quite popular during the last few years. In former communist societies, however, scepticism toward anything formal is (still) widespread and there is considerable disregard for the rule of law.[9] People often seek to do things informally rather than in a formal manner and outcomes are often sought through the circumvention of formal rules and regulations. We have therefore found it useful to approach the culture of informality in public procurement by focusing on the use of contacts and informal networks in this sector.

Most people have access to potential contacts – either directly, through personal knowledge, or indirectly, though other people they know. In case of need they know that they can approach the potential contact and request his/her assistance. In some cases assistance may be given – but often at a cost, as the requester would be expected to return the assistance rendered in one way or the other. In other cases, the potential contact may feel that the cost of their rendering the requested assistance would be too high, thus choosing to turn down the request. Similarly, an informal network may mobilise its resources and be more active in some situations than in others. There may also be some disagreement within the network as to which situations call for mobilisation. Still, the members of the informal network are linked to each other and are thus in a position to mobilise parts of or the entire network as need be.

The following definitions were chosen given that the focus is on the actual rather than the potential use of contacts and informal networks: A "contact" is defined as "a person who is able to and willing to help someone", whereas an "informal network" is defined as "an informal circle of people able to and willing to help each other". The two terms are not mutually exclusive: a contact can of course also be part of one or more informal networks. Similarly, members of informal networks may resort to 'contacts' outside their networks. Besides, a contact may convey a request on behalf of one individual or a group of individuals. Similarly, an informal network may convey a request on behalf of, or through, several of its members or an individual member. Focusing on contacts and informal networks therefore does not allow us to distinguish between the individual approach on the one hand, and the collective approach on the other. It does, however, allow us to distinguish between requests made directly by the requester – *i.e.* by one or more members of the informal network on behalf of either themselves or the informal network – and indirectly (on behalf of an individual or a group of individuals) through a contact.

The distinction is also useful in that contacts are often sought on an on-off basis whereas informal networks are linked together by people whose shared interests are usually more long term. From a resource point of view it also makes sense to distinguish between contacts and informal networks. Although a contact may be a very powerful individual with access to considerable financial and/or other resources, and for this reason may be highly influential, the informal network is able to draw on the collective resources of all its members. Besides, because of the shared sense of loyalty to the network on the part of its members as well as fear of being excluded from the group, members could be more likely to make their resources available to other members of the network as required. This, in turn, gives members of informal networks an advantage as far as influence is concerned.

Contacts and informal networks are in themselves neither positive nor negative. Both can be used for legitimate or illegitimate purposes. To the extent they are used for legitimate purposes, they may help people get something to which they are entitled by law – for instance publicly available information, assistance from public offices and the like. Informal networks may also help facilitate trust and professionalism in society, as members know they can rely on each other and are often also well qualified people. However, they may also be used for more clandestine purposes, such as giving people access to something to which they are not entitled, undermining fair competition and professionalism in society and promoting illegitimate interests and corruption.

Main findings of the study

All countries included in the project have during the past couple of years introduced modern and comprehensive public procurement legislation, the aim of which is to ensure that public procurement procedures are transparent and fair. However, corruption still appears to be a problem in public procurement in East Central Europe and the Balkans.

Findings from interviews with representatives of national and international businesses indicate that the culture of informality is very much a part of the problem: contacts and informal networks are used in public procurement, and they are used not only for obtaining information about tender requirements and procedures but also to influence the outcome of the tender procedures themselves. Sometimes they are used to determine what kind of tender is eventually made. At other times they are used to dissuade competitors from taking part in the tender procedure or to ensure that competitors are disqualified on formal grounds from competing for the tender. Contacts and informal networks also facilitate payments (*i.e.* kickbacks) to ensure that certain interests are being favoured during the tender. Such payments are sometimes initiated by commercial groupings, sometimes by the public procurement officials themselves. The stories told by the business representatives are made all the more credible by the fact that they are not only talking about such practices in general terms and based on hearsay, but also referring to the specific experiences of their own companies.

These findings are supported by statements made by the public procurement officials themselves. They confirm that contacts and informal networks are widely used in public procurement and that they are influential. A large majority of the public procurement officials interviewed had received requests for favours, such as inside information and requests to lobby certain interests or favour certain companies when awarding tenders. Such requests were often accompanied by attempts at influencing the public procurement officials either by pleading, offering bribes or by exerting various types of pressure. Several respondents had been approached by informal networks and claimed that their requests were usually more extensive than requests made by others. Moreover, such requests were usually conveyed in a more forceful manner than other types of requests.

One would expect contacts and informal networks to be more commonly used in Bulgaria and Romania than in the Czech Republic and Slovenia – partly as the latter have joined EU and thus fully complied with the "acquis", and partly as Slovenia has a better ranking on Transparency International's 2004 anti-corruption index than the other three countries.[10] One would also expect Romania to fare worse in terms of the illegitimate use

of contacts and informal networks than Bulgaria, as Romania has not made as much progress as Bulgaria in its adjustment to EU requirements for membership. Corruption is currently so widespread that EU has threatened to delay Romania's entry into the EU unless effective measures are taken to reduce its level.

The project findings only partly confirm these hypotheses. In numerical terms, the Czech and Romanian respondents talked more about contacts being commonly used in public procurement than the Slovenian and Bulgarian respondents. Similarly, informal networks appear to be more influential in the Czech Republic and Slovenia than in Bulgaria and Romania. Numbers are, as mentioned earlier, only part of the story. The way in which the Czech and Slovenian respondents spoke about the illegitimate use of contacts and informal networks in public procurement was neither as explicit nor as bad as the stories told by the Bulgarian respondents. Though some of the Romanian respondents also gave explicit examples of how contacts and informal networks were used in an illegitimate manner in their countries, their stories were not as bad as those told by the Bulgarian respondents.

The hypotheses may, of course, be wrong. Other explanations seem more plausible, however. One explanation why the findings from Romania only partly confirm the hypotheses could be the extensive anti-corruption campaign that was launched in Romania at the time the interviews were taking place. The campaign may have made respondents more reluctant to talk about the use of contacts and informal networks in public procurement for fear of exposing themselves – despite repeated assurances that their answers to our questions would not be disclosed to a third party. The Romanian respondents did come across as rather cautious compared to respondents in the Czech Republic, Slovenia and Bulgaria. It is also worth noting that the refusal rate for interviews in Romania was considerably higher than in the other countries, at roughly 40%. The Romanian respondents also answered fewer questions than the respondents in the other countries.

The limited number of in-depth interviews conducted may of course also have contributed to differences between countries that were not expected. For this reason, it cannot be concluded that the findings are representative of the views and experiences of business representatives and public procurement officials in the Czech Republic, Slovenia, Bulgaria and Romania as such. Samples have been designed in such a way, however, that there is no reason to believe that they are not representative. Larger national quota-based surveys due in 2005 will generate more representative data and hopefully also confirm at least some of the findings from these in-depth interviews.

The views expressed and personal experiences referred to by these respondents are, however, valid as the views and experiences of 120 people working in business and public procurement in East Central Europe and the Balkans. Their experiences indicate that contacts and informal networks are used in public procurement, and that they are used to distort the outcome of public tenders. It thus seems reasonable to conclude that efforts to improve transparency and reduce the scope of corrupt practices in public procurement must address the culture of informality prevalent in this sector, as well as the laws and rules regulating the tender procedures, in order to be successful. This could be done through education and awareness-building among those involved in public

procurement, as well as by introducing measures aimed at exposing the negative manifestations of the culture of informality within this sector.

Ways in which contacts and informal networks are used in public procurement: the business perspective

A fairly large share of our respondents thought the use of contacts and informal networks in public procurement was widespread, and that they were influential. Whereas respondents from the Czech Republic, Slovenia and Bulgaria tended to focus on their illegitimate use, Romanian respondents were more cautious: "…for example, when a tender is organised, me, my friend or my partner know the ones organising the tender and we have access to semi-confidential information related to this tender. This information cannot influence the result of the tender, thus corruption is not involved. However, if due to my special relation to the organisers I am the one winning the tender, and things are arranged so I can win, then we have corruption." (Int-bus 5, Romania); "…in public procurement we're talking about supra-regulation generated by a general lack of trust, so the chances of networks being involved…However, there's a lot of talk on this subject. I have worked in public procurement, I have participated in public bids, and I have seen that the noise is bigger than reality. Precisely because of this supra-regulation, the impact of networks is limited." (Int-bus 1, Romania).

Contacts and informal networks may be used legitimately to obtain information and to avoid bureaucratic obstacles that could prevent them from taking part in the public tender in the first place: "I am working in the construction branch and without contacts…on different local councils and eventually in higher state offices, you have no chance. I am not talking about corruption, but about the ability to be in the right place at the right time…You will receive information that the local council is preparing the public procurement and under what conditions, etc. Further on, you need various agreements, to obtain permissions, you need them fast so you have to know where or to whom you have to go, whom to call, etc." (Nat-bus 1, Czech Republic); "…administrative obstacles are numerous so people seek mechanisms to avoid such obstacles. The informal network is a very convenient way to avoid such obstacles." (Nat-bus 5, Bulgaria).

The large majority of the business representatives that we interviewed, however, held the view that contacts and informal networks were primarily used to influence the outcome of public tenders, and they gave examples of how this was done. Most of their examples were based on hearsay rather than on their own personal experience.

Influence on the tender could be exerted at the preparatory stage: "…the influences occur where people are involved: in defining the terms of the bid, the specifications, the selection criteria and so on. If the offer is made public today and the applications are due tomorrow, it's obvious that only those who knew about it will be able to apply…" (Int-bus 1, Romania).

Once a tender has been made public, there are several ways in which the outcome may be distorted. One way is to discourage companies from taking part in the tender in the first place. If this doesn't work, then competing bidders for the tender may simply be disqualified from taking part in the tender on arbitrary technical grounds: "…there are open contests, candidates apply with a concept and in most cases the winner is known prior to the beginning of the contest, *i.e.* the informal network there has its own channels and ways to make the other participants desperate: there is no point to participate because Mr A will win and I can guarantee that in advance…even if enough offers are submitted,

then the committee disqualifies competitors of the previously selected winner, so that at last the network's favourite wins the contest." (Nat-bus 9, Bulgaria).

Some respondents in the Czech Republic and Bulgaria were aware of specific cases of unfair public tenders: "…I know companies which get public procurements on the basis of direct personal contacts.' (Nat-bus 7, Czech Republic); "…I have witnessed informal attempts made by friends and acquaintances for awarding the public procurement to a definite company..." (Nat-bus 5, Bulgaria).

Other respondents were so convinced that such tenders are not fair that for this reason they simply did not feel like taking part: "Public procurements…I am not participating in these things…every second (maybe more) public procurement is not public – it is decided in advance." (Nat-bus 6, Czech Republic); "I personally ceased participating and only from time to time – for the sake of 'sport passion' – take part in such events and I see how deplorable the results are." (Nat-bus 7, Bulgaria); "There are no real tenders, all the tenders are staged and contacts are used there…that is why we no longer participate there – this is not a tender, this is an agreement." (Int-bus 9, Bulgaria).

Our respondents held the view that sometimes the use of contacts and informal networks is initiated by the officials in charge of the tenders, sometimes by business people seeking to win the tenders: "The problem is that in our sphere of activity the people who are in charge of public procurement are, in fact, government officials who deal with somebody else's money – state money, public money – and they feel the urge to use up some of this money and they cannot do this unless they use another person who resorts to them, *i.e.* I for example. And by the way they are the active part looking for this type of contacts…It is very common…In relation to public procurement." (Nat-bus 7, Bulgaria); '…I know people who tour the mayoral offices throughout the country and set up such networks – when an order comes, I won't say here what orders, everyone in the mayoral office knows how much money he/she would get if he/she assigns the order. So those people set up networks of civil servants and feed them with money and gifts." (Nat-bus 8, Bulgaria); "…here is an advantage that somebody can mediate you some procurement". (Nat-bus 2, Czech Republic).

Even after winning a public tender – whether in a legitimate or illegitimate manner – a company may still fall victim to contacts and informal networks: "There are informal networks active in business and they are based largely on common economic interests. A typical practice involves nominal tenders where things have been arranged in advance. They have a very strong influence as regards public procurement, as well. It is common for a company that has won a tender to be told what kind of materials it has to work with and not to let it choose from what is available in the market. In this sense, the tender is predetermined but that cannot be proven." (Int-bus 8, Bulgaria).

Most of the examples given above may be referred to as illegal, but not corrupt. Circumventing the laws in order to secure a favourable outcome of a public tender does not in itself represent an act of corruption. Paying a bribe to somebody in order to obtain a public contract, however, would be not only illegal but also corrupt. Respondents were therefore asked whether they thought various sectors of society – including public procurement – were corrupt.

Respondents in all countries were convinced that due to the extensive use of contacts and informal networks in public procurement, corruption in this sector is widespread. Whereas respondents in the Czech Republic, Slovenia and Romania talked about corruption in public procurement in more general terms, Bulgarian respondents indicated

that the use of kickbacks is commonly used in their country: "as for the public procurement system, my feeling is that it has been established to promote corruption. There is a zero chance of success if you take part in a public procurement tender in the normal way and you have no access to the person who is in charge of things. And if you are ready to take up things in an irregular manner (you have to) promise something in exchange for the favour…" (Nat-bus 7, Bulgaria); "because so much public procurement means payment underneath the counter and brings a price hike, which is to the advantage of a certain group of people...the 10% - most often it is (even) more than 10% – is a common practice in most companies…" (Int-bus 5, Bulgaria).

None of the respondents said their companies had won tender procedures by making use of contacts and informal networks or by offering or paying bribes to public procurement officials. Nor did any of them admit that their companies had colluded with other companies to win public tenders. They did, however, speak of how their companies had failed to win public tenders – some because they refused to pay kickbacks: "…he reminds me he is influential and reaches contacts. For example he says he has a good contact at the ministry where we apply for public procurement and if we give some money to his foundation, he helps us get this public procurement through his contact. I can say he was not successful." [in bribing the speaker] (Int-bus 9, Czech Republic); "there was (a) huge public tender for a design project and then I was asked to pay DEM 5 000 (deutschmark), in order to win the tender. The selected candidate was awarded an DEM 80 000 contract. So I asked if I had to give the money to the committee in charge of considering the offers. They told me I had to give the money to a deputy minister. I refused to give the money to a person who was not in the committee, who was 'only' influencing the committee, because if I had to give the money to the committee, it was clearly a tender requirement. So I didn't pay the money, filed a bid, but did not win the tender." (Nat-bus 8, Bulgaria).

Others failed to win because competing companies had already secured the outcome of the tender: "…public procurement is organised in such a way as to prevent mega corporations from winning the procurement. Informal activities are evident in arranging the criteria in such a way as to re-confirm known local companies, which have won the order before, in the many routine actions which put participants having long-term contacts in the respective sphere at an advantage to other bidders. For example in a recent public tender for some production equipment the tender requirements were set in such a way (quality of the equipment was not so essential in evaluation of offers) as to tip the scales in favour of a local company, which in the end won the tender, but which was offering low-quality product and high price…" (Int-bus 4, Bulgaria).

Ways in which contacts and informal networks are used in public procurement: the public procurement perspective

To find out how common the use of contacts is in public procurement, the public procurement officials were asked to indicate how widespread the use of contacts was in their sector compared to other sectors. While admitting that contacts are also common in public procurement, they thought the use of contacts was considerably more widespread in public administration generally (all countries), business (all countries), politics (Slovenia and the Czech Republic) and the police (Czech Republic). However, when specifically asked whether contacts were commonly used in their own sector, the large majority of respondents answered in the affirmative – though some claimed that contacts are not as commonly used in public procurement now as they were in the past.

Table 7.1 The use of contacts in the Respondent's own sector

	Czech R %	Slov %	Bulg %	Rom %
The use of contacts is common	83	20	38	94
Contacts are used	---	27	44	---
The use of contacts is uncommon	17	20	19	---
Contacts are not used	---	13	---	---
Other/Don't know	---	20	---	6
N=	(23)	(15)	(16)	(18)

Note: N = the total number of text units. Each text unit represents an answer to a question given by one respondent.

Some of the Slovenian and Bulgarian respondents pointed out that contacts in public procurement were used in a positive sense, to obtain relevant information about tenders. Bulgarian respondents also went to some length to justify their use: "You get information faster, you get better information. That is not bad…" (Proc-7, Slovenia); "…the use of acquaintances is limited to 'getting more detailed information' but this would not permit a person to win a contract…" (Proc-7, Bulgaria); "obtaining such information is not unlawful; it's the kind of information that everyone ought to be able to get." (Proc-7, Bulgaria).

Other respondents did, however, concede that contacts and informal networks are used to somebody's advantage in public procurement. To the extent they did, however, they spoke in fairly general terms rather than giving examples from their own personal experience: "Connections and contacts are definitely in demand…some candidates (for public tenders) are all too often unduly eliminated for purely formal reasons. Supposedly because the presented company registration certificate is not an original or for some other similar reasons, which (are) unfounded. In this way, most of the candidates are rejected on formal grounds leaving only the favoured ones…In this case, one must seek contacts with the members of the tender commission or public procurement office. In any municipality or ministry, it is well known who is involved in public procurement. If some official is not involved today, he will be tomorrow. In any case, the officials in these institutions are connected with each other as colleagues. This is how one seeks connections on a lower level. Sometimes people try to make contact with the head of the particular institution himself…." (Proc-2, Bulgaria); "in Botosani, four years ago, people wanted water supply, but the mayor wanted gas supply. And it was not a lack of communication. This meant that the mayor had a friend who had a firm in gas industry, and not a friend involved in water supply industry." (Proc-4, Romania).

Public procurement officials in all countries held the view that informal networks were most influential in politics (Czech Republic), in politics and business (Slovenia), in business and politics (Bulgaria) and politics and the media (Romania). Still, a fairly large share of the Czech public procurement officials and also quite a few of the Slovenian officials – though none of the Bulgarian and Romanian ones - thought that informal networks were most influential in public procurement.

Respondents were also asked what types of informal networks were active in their sector. As can be seen from Table 2, in the Czech Republic networks of former fellow students and schoolmates were involved in public procurement: "Former (fellow) students…" (Proc-6, Czech Republic); "…there are people, for instance, who are graduates from one and the same year…" (Proc 4, Bulgaria).

Networks of former and current colleagues and networks of acquaintances and friends were also used in the Czech Republic, as well as in Bulgaria and Romania: "former colleagues and current colleagues, friends from various clubs, etc…" (Proc-6, Czech Republic); "They act on the basis of friendship ties and on party alliance. They operate for occupying positions and doing favours and the kinds of activities that I mentioned previously." (Proc-8, Bulgaria); "Yes, informal networks are active including in my working area: these consist mostly of ex-faculty colleagues or even acquaintances that one makes during everyday work." (Proc-7, Romania).

Some of the Czech and Bulgarian respondents claimed that political and economic networks were active in public procurement in their country: "Networks of political parties" (Proc-2, Czech Republic); "Interconnection of political party and entrepreneurs." (Proc-10, Czech Republic); "The municipal counsellors are appointed, they belong to the respective parties. This party quota principle allows certain groups gravitating around the municipal councillors to try and use privileges, preferences, especially in some delicate areas, and despite the normative regulations for public procurement." (Proc-6, Bulgaria).

In Slovenia lobby-style networks were also used: "Politicians press subtly, they do not call directly, they ask why did you do this or that. There is no difference between position and opposition. That is why chiefs (of departments) must be strong people to defend themselves from pressures…" (Proc 3, Slovenia); "There are political influences of more networks…they are not economic networks, they are mainly political networks. Politicians work through middlemen. In the first instance they contact us by telephone." (Proc 4, Slovenia).

Table 7.2 Types of informal networks operating in the respondent's own sector

	Czech R %	Slov %	Bulg %	Rom %
Networks of acquaintances and friends	14	---	29	25
Networks of colleagues	14	---	14	25
Lobby-style networks	---	33	14	---
Networks of former fellow students/schoolmates	29	---	---	25
Other	43	67	43	25
N=	(7)	(3)	(7)	(4)

Notes:
(1) N = the total number of text units. Each text unit represents an answer to a question given by one respondent.
(2) The percentages for "other" are high in all countries. This is primarily due to the reason that several respondents simply spoke about networks in a general rather than in a specific manner.

When specifically asked whether informal networks are influential in public procurement, a majority of the Czech and Slovenian respondents voiced the opinion that they were: "Yes, they exert pressure to be successful in winning the order, public tender procedure." (Proc-6, Czech Republic); "Yes, in the Ministry of Finance there is, but more in the Ministries of Environment, Traffic and others, mainly in the Ministries that have the biggest public procurements in the state..." (Proc-1, Slovenia); "Politicians press subtly, they do not call directly, they ask you why did you this and that…" (Proc-3, Slovenia).

Bulgarian respondents were divided. Some thought informal networks are influential in public procurement whereas others were either unsure or thought informal networks were not influential. Similar views were voiced by some of the Romanian respondents: "…the municipal counsellors are appointed, they belong to the respective parties. This

party quota principle allows certain groups gravitating around the municipal counsellors to try and use privileges, preferences, especially in some delicate areas, and despite the normative regulations for public procurement. There are plenty of ways in which this can be done. I know quite a few cases of people who, motivated by economic interests, have more than once changed their political affiliation." (Proc-6, Bulgaria); "they might be active. There are people, for instance, who are graduates from one and the same year. Though one can see this everywhere, in political groupings, among MPs." (Proc-4, Bulgaria); such networks simply do not exist here." (Proc-7, Bulgaria); "no, they are not…(this) would be something similar to the traffic of influence." (Proc-4, Romania).

Table 7.3 The influence of informal networks in the respondent's own sector

	Czech R %	Slov %	Bulg %	Rom %
Informal networks are influential	79	78	50	33
Informal networks are not influential	21	22	50	44
Other	---	---	---	22
Don't know	---	---	---	---
N=	(14)	(9)	(5)	(9)

Note: N = the total number of text units. Each text unit represents an answer to a question given by one respondent.

Respondents answered the questions about contacts and informal networks in a fairly general manner rather than talking about their own personal experience. As people's opinions are often shaped by information obtained from the media or from other people's stories rather than their own experiences, respondents were also asked specific questions about their personal experiences with and exposure to contacts and informal networks.

They were first asked what types of requests they have themselves received through their work. As can be seen from Table 4, whereas requests for information were common, a majority of the requests they had received were related to various types of favours.

Table 7.4 Type of requests made to the respondent

	Czech R %	Slov %	Bulg %	Rom %
Requests for information	30	22	35	22
Requests for legal issues	10	26	21	11
Requests for favours	40	43	29	44
Other requests/Don't know	20	9	15	22
N=	(20)	(23)	(34)	(18)

Note: N = the total number of text units. Each text unit represents an answer to a question given by one respondent.

According to the Czech and Slovenian respondents, requests for information regarding tender procedures were legitimate. They did, however, admit that the more information a company has about a public tender, the higher its chances of winning it. As such, providing information – even information that is not classified, but difficult to obtain – is questionable: "(People ask me for) information about rules, how the tender procedure will proceed, which local campaign is planned." (Proc-1, Czech Republic); "people want to get information, information concerning public tenders (from me). They want to get the most information to win in public tender." (Proc-3, Czech Republic); "People have occasionally turned to me with some request, but in most cases they concerned standard and routine matters and did not go beyond what is provided by the law…let's suppose a tender has been announced and a friend of mine takes an interest in

it but does not know where he/she could obtain information concerning the papers required, the terms and tender procedure. Well, he/she phones me asking for the relevant information and I put him/her through to the right people. Or, here's another case: some people call me asking for information they are entitled to, which I myself can provide, information which is not classified, but if they go through official channels they will waste a lot of time." (Proc-1, Bulgaria).

Other respondents said they had been requested to ensure that the tender procedures would be followed and that no company receive any special advantages – *i.e.* defending the right to a fair tender: "Most often they ask me to guarantee, that the valuation commission evaluating level of offers will use working process by law, that no applicant will get advantage (favour) against law – by using influential friends and interventions." (Proc-1, Czech Republic).

Most requests received by respondents in the Czech Republic, Slovenia and Romania, however, were requests for favours. When specifically asked if they had received requests for favours, an even larger number of respondents admitted that they had:

Table 7.5 Whether respondent has received requests for favours

	Czech R %	Slov %	Bulg %	Rom %
Respondent has received requests for favours	83	42	55	100
Respondent has not received requests for favours	17	58	18	---
Other/Don't know	---	---	27	---
N=	(18)	(12)	(11)	(9)

Note: N = the total number of text units. Each text unit represents an answer to a question given by one respondent.

The public procurement officials interviewed had been asked for a wide range of favours. Sometimes people requested inside information: "they try to gain information, that which is closed (internal) or to gain information in advance." (Proc-10, Czech Republic).

In other cases the procurement officials were requested to lobby certain interests: "It was about some business matters; the discussions centred around business matters. It was lobbying in favour of a particular person's business interests…these requests may be connected both with my specific work and with getting access to other people. Things are really interwoven." (Proc-3, Bulgaria).

Or they were given recommendations regarding what companies to choose in connection with public tenders: "(They ask me) to ignore the shortages in contracts or offers, to give them preferential treatment in contracts, to accelerate the execution of their request. People who make such requests are entrepreneurs and members of political parties." (Proc-10, Czech Republic); "They generally demand that I do my best to (ensure) that they are winners in public tender procedures or (they) ask me to help them to transmit their application to the exact (appropriate) person who can decide to win in public tenders procedure for their benefit.…Private entrepreneurs contact me in this way." (Proc-6, Czech Republic); "(I have been asked to) intervene…we can influence

public procurements..." (Proc-1, Slovenia); "Usually it's for receiving certain advantages. I'm referring to winning a competition…" (Proc-6, Bulgaria).

Most public procurement officials interviewed said that people approaching them with different requests usually sought to influence them in various ways in order to secure a certain outcome. Some people try to plead, others to exert pressure: "They try to persuade me. They use a lot of arguments in persuding." (Proc-5, Slovenia); "I have never received bribes or threats, but those that contacted me tried (to influence me) by persuation, by friendly behaviour." (Proc-7, Romania): "Usually they send a person I can't refuse to ask for my help." (Proc-2, Bulgaria); "They even tried to pressure not only us – the officials at the Ministry – but also the Minister to rule in favour of a particular person…" (Proc-3, Bulgaria); "People admitted many times that they searched for someone close to me, in order to influence me." (Proc-3, Romania); "They complained at ministerial level or convinced them [*i.e.* ministerial staff] to call me from the ministry." (Proc-6, Romania).

Some offered something in return for complying with their requests, while others resorted to threats: "They usually use a bribe…at most a bottle of good distillate, for example whisky or brandy." (Proc-6, Czech Republic); "I have even refused a request which was supported by a bribe (for example CZK 20 000 …" (Proc-9, Czech Republic); "People who have no connections use corruption. Business people with no connections can offer only corruption. They offer directly or they say what they could do for you. They like to help politicians during elections." (Proc-3, Slovenia); "(some people) try to influence me not only by pleading with me, but also by suggesting that they would make it up to me somehow…" (Proc-2, Bulgaria); "Yes, there have been threats and offers of favours in return and even proposals of money…" (Proc-8, Bulgaria); "They try even to threaten with reclamations or to bring the mass media…" (Proc-2, Romania).

Table 7.6 Attempts at influencing the respondent when making requests

	Czech R %	Slov %	Bulg %	Rom %
People making requests try to influence the respondent	89	88	59	100
People making requests do not try to influence the respondent	6	6	15	---
Other/Don't know	6	6	26	---
N=	(18)	(17)	(27)	(9)

Note: N = the total number of text units. Each text unit represents an answer to a question given by one respondent.

When answering questions about the kind of requests they had received and also whether the people requesting their assistance tried to influence them in one way or another, most respondents did not distinguish between requests received by people more generally, contacts and informal networks as such. As we are particularly interested in informal networks, we asked the respondents whether they had themselves come into contact with informal networks in their work. A majority of the respondents in all countries answered this question in the affirmative. Some of them spoke about informal networks in fairly general terms, whereas others were more specific, referring to particular types of informal networks.

Table 7.7 Respondent's exposure to informal networks

	Czech R %	Slov %	Bulg %	Rom %
Resp. contacted with requests by informal networks	71	78	37	27
Resp. not contacted with requests by informal networks	19	17	26	18
Other/Don't know	10	6	37	55
N=	(21)	(18)	(19)	(11)

Note:
(1) N = the total number of text units. Each text unit represents an answer to a question given by one respondent.
(2) The percentages for "other"/"don't know" are high for both Bulgaria and Romania. The main reason for this is that some respondents evaded our question by making comments that did not provide an answer to our question.

We were interested to know whether requests made by informal networks differed from requests made by others. Most respondents in Slovenia and Bulgaria as well as well as quite a few of the Czech respondents thought requests made by informal networks were different and they gave several examples.

Requests made by informal networks as a rule tend to be more extensive than requests made by people not belonging to or affiliated with informal networks – though these requests are not always very clearly formulated: "Their requests are more extensive…" (Proc-10, Czech Republic); "the business effect from the request is more hidden" (Proc-10, Czech Republic); "they are talking between the lines." (Proc-5, Slovenia).

Some respondents also pointed out that people representing informal networks behave differently from other people: "Members of networks know what kind of way they have to use to be successful…" (Proc-8, Czech Republic); "…they act very self-confidently." (Proc-7, Slovenia); "They contact higher ranks. They are very polite." (Proc-9, Slovenia); "They are more classy." (Proc-3, Slovenia); "People not belonging to a network tend to be less aware of their rights…people belonging to networks are perfectly aware of what their rights are and stand up for their rights. Another difference is that ordinary people all too often do not expect that their requests will be satisfied." (Proc-1, Bulgaria).

Members of informal networks make it clear to the public procurement officials what interests they represent: "…There are also people who come and tell me that they are recommended by someone important. Basically, in comparison with the others, those who represent a network make me pay attention to the fact that they have a certain contact that sent (them) to me." (Proc-6, Romania); "…MPs trying to exert influence on us in connection with certain business interests, is an example of an informal network. It was a network, in which both deputies of the National Assembly and business people took part…in this particular case, the MPs acted on behalf of business people we did not know. We eventually got to know them, but…at the beginning they were unfamiliar to us…" (Proc 3, Bulgaria).

Informal networks are also often in a position to exert considerable pressure on public procurement officials to get their way with them: "They order." (Proc-8, Slovenia); "(Requests) differ because (the informal networks) expose the consequences (of not complying with their requests)." (Proc-10, Slovenia); "I think they are intrusive and more aggressive." (Proc-6, Czech Republic); "If they do not succeed the first time they send a

person who tells directly which group he represents. They expose the consequences if the job would not be done and they will contact higher ranks." (Proc-10, Slovenia).

A majority of the public procurement officials interviewed claimed that it was not more difficult to turn down requests from informal networks than to deny requests made by others. Their statements to the effect that informal networks are influential in public procurement, however, may be taken as an indication of the opposite.

Table 7.8 Requests from informal networks vs. requests by other people

	Czech R %	Slov %	Bulg %	Rom %
Requests are similar	44	20	23	---
Requests are different	33	70	38	---
Other/Don't know	11	---	38	---
Respondent has not received requests from informal networks	11	10	---	---
N=	(9)	(10)	(13)	(0)

Note:
(1) N = the total number of text units. Each text unit represents an answer to a question given by one respondent.
(2) None of the Romanian respondents answered our question – in some cases the interviewers failed to ask the question, in other cases the respondents refused to give an answer to the question.

Notes

1 William L. Miller, Åse Berit Grødeland and Tatyana Y. Koshechkina. A Culture of Corruption? Coping with Government in Post-communist Europe (Budapest: Central European University Press, 2000), pp. 141-42; Charles Lor and Anca Pusca in 'The Political Economy of Corruption in Romania' presented at the Annual Meeting of the British Political Studies Association at the University of Lincoln in 2004..

2 Slovenia, Bulgaria and Romania have slipped back on the TI Corruption Perception Index during the last few years. While Slovenia ranked 27th in 2002, it ended up 29th in 2003 and 31st in 2004. Bulgaria came 45th in 2002 and slipped back to the 54th place in 2003 – a place it also occupied in 2004. Romania's position on the ranking list has deteriorated steadily: whereas Romania occupied the 77th place in 2002, it came 83rd in 2003 and 87th in 2004. The Czech Republic finished up on 52nd place in 2002, occupied the 54th place in 2003 and came 54th in 2004. Source: www.transparency.org

3 Open Society Institute. *Monitoring the EU Accession Process: Corruption and Anti-Corruption Policy* (Budapest: Open Society Institute, 2002).

4 Measures aimed at reducing the level of corruption in countries in East Central Europe as part of the "acquis" have been predominantly formal in nature. To some extent their lack of impact is caused by the shortcomings of the conditionality requirements themselves, as well as by the arbitrary manner in which

their impact has been assessed on the part of the EU. Besides, in many of these countries there is a lack of political commitment to anti-corruption reform: campaigns are launched, some formal changes are made, and corruption continues to be a problem. Several countries in East Central Europe and the Balkans are also plagued by a general disregard for the law and weak judiciaries.

5 Ledeneva quoted in Alina Mungiu-Pippidi. 'Informal Institutions and Societies. Post-Communist Modernization Strategies in East Central Europe.' State-of-the-art paper for ECPR Research Group on Informal Institutions in Eastern Europe.

6 Ten interviews per country with public procurement officials, representatives of national businesses and foreign businesses, respectively.

7 NIBR has also recruited two network-specialists based in Western Europe into the project as consultants – Dr Alena Ledeneva (SSEES, University College London) and Dr Heiko Pleines (Forschungsstelle Osteuropa, Bremen).

8 Miller, Grødeland and Koshechkina (2000).

9 Ibid.

10 The Czech Republic and Bulgaria were both occupied the 54th place on the 2004 ranking.

Annex 7.A.

Methodology

Work on the project commenced in March 2003 and will be completed in March 2006. Data for the project are collected in three stages: 1) in-depth interviews; 2) roundtable discussions and 3) national quota-based surveys. The in-depth interviews and roundtable discussions have already been completed, whereas the national surveys are due in 2005.

During the winter of 2003/04 the project team conducted a total of 360 structured, open-ended in-depth interviews – 90 interviews per country with nine categories of respondents. Half of these interviews were being carried out with respondents operating at the national level, whereas the other half were carried out at the regional (capital) level to allow for comparison of informal networks operating at different administrative levels.

More specifically the following categories of respondents were interviewed: 1) elected representatives; 2) public procurement officials; 3) prosecutors and judges; 4) national business representatives; 5) international business representatives; 6) political party representatives in charge of party finances; 7) media representatives; 8) national and international NGOs; and 9) EU and Council of Europe representatives and national government officials working in the field of anti-corruption.

Each interview lasted for approximately one hour and was conducted in the local language by professional interviewers. All interviews were carried out according to a pre-prepared interview guide, consisting of five main sections: 1) general views on the rule of law; 2) general views on the use of contacts; 3) general views on informal networks; 4) personal exposure to and use of contacts and informal networks; and 5) general views on how to strengthen the positive aspects of networks while limiting their negative aspects.

English language transcripts of the interviews were coded in QSR NUD*IST – a software for qualitative data analysis – according to a detailed coding scheme consisting of more than 60 nodes (or coding categories) – and sub-nodes. The text unit – the basic unit to be coded – was defined as a respondent's answer to a question, starting when the respondent started to speak and finishing when the respondent either stopped talking or was interrupted by the interviewer.

Some double-coding did occur in cases where the respondent's answer to a question addressed issues covered by more than one node. In some cases respondents provided answers to one question when answering others. In such cases, more than one answer from one and the same respondent was coded at the same node. Furthermore, some respondents failed to answer all the questions. The total number of text units (N) in the

tables below therefore does not always correspond to the total number of respondents interviewed.

Once the data set had been coded, the total number of text units coded at each node was recorded and percentaged. This allowed for the creation of tables based on the numerical findings from the four national data sets (N=90 pr country).

We also wanted to establish (a) whether there were any major differences between the nine categories of respondents interviewed, within each country; and (b) whether there were any major differences between the nine categories of respondents in the different countries.

For this purpose nine independent variables were created – one for each category of respondents included in the project. All statements made by all respondents belonging to the public procurement category were coded at a "public procurement node", all statements made by all respondents from the national business category were coded at a "national business node", and so forth. Each independent variable was cross-tabulated with all the dependent variables (nodes and sub-nodes)[1] and the total number of text units retrieved from each cross-tabulation put in tables and percentaged.

Analysing qualitative data statistically is in itself not sufficient, however. To give an example, several respondents may hold the view that informal networks are more common now than they were before 1989. Still, they may have different opinions as to why or in what way informal networks are more common now. To get the full picture, it is necessary to combine the statistical findings with a content analysis of what the respondents actually said.

The chapter presents findings from this combined analysis: numerical findings are presented in table form and "illustrated" by quotations from the in-depth interviews.[2]

1 Each respondent's answer to a particular question was coded at the same node and treated as an independent variable.

2 As can be seen from some of the tables, the number for 'other/don't know' is in some cases quite high. This is not a result of people not having an opinion. Statements that did not fit into the coding scheme were coded as "other" during initial coding. Statements coded in this way will later be recoded, which will in turn reduce the number of statements coded as "other/don't know".

Chapter 8

Russia: Conflict of Interest and Related Corrupt Practices in Public Procurement

by

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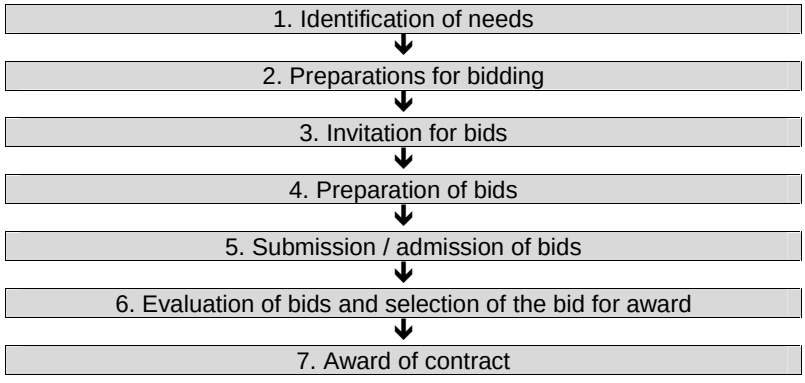
The public procurement figure in Russia has risen from RUB 146 billion in 1999 to RUB 615 billion in 2003. This increase in volume is partly due to sharp increases in the federal budget. Still, the Russian government estimates that savings of up to 10-15% could be achieved if public procurement rules are properly implemented and followed. One additional, very serious aspect of effectiveness has not been taken into account – corruption prevention.

Background information on public procurement

Worldwide, the following methods of public procurement are used to provide competition between prospective suppliers (bidders): open and closed biddings (either single-stage or two-stage procedure), various negotiation procedures, regulated non-competitive methods for procurement of small contracts (shopping, catalogue purchasing, direct contracting). In case of a lack of competition or urgent needs, direct contracting (single source) is used.

Common to all competitive methods of procurement are a number of basic steps: the purchaser's notification to prospective suppliers of requirements and contract specifications; preparation of price and technical proposals by bidders; and evaluation of bids by the purchaser and selection of the bid with the best conditions. Competitive bidding commonly forms the basis and is the most recommended method of public procurement. General bidding procedures can be illustrated in the following figure.

Figure 8.1. General bidding procedures



Public procurement is regulated by several legislative acts: the Civil Code of the Russian Federation; the Budget Code of the Russian Federation; the Federal Law "On Tenders for Placement of Orders for the Supply of Goods, Performance of Works, Provision of Services for the State Needs" No. 97-FZ, 6 May 1999; the Decree of the President of the Russian Federation "On Priority Measures to Combat Corruption and Reduce Budget Expenditures through Organising Tenders to Procure Products for the State Needs" No. 305, 8 April 1997, and a number of other federal acts as well as regulations.

Open bidding is the main method of public procurement in Russia. Notification of bidding opportunities should be published in the specialised national press or the official gazette accessible to any bidder. National legislation provides bidders with a period of at least 45 days in which to prepare their bids. The latter should include, *inter alia*, the

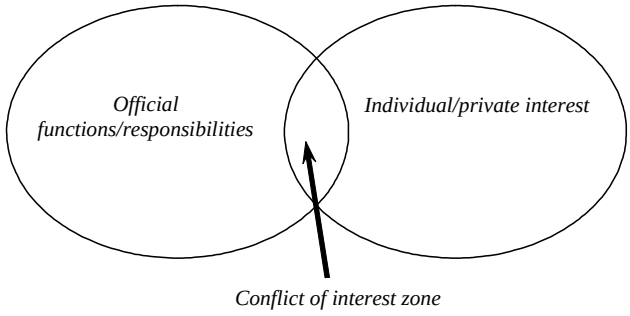
following: information about the supplier; information certifying the bidder's legal capacity and qualification; and technical and commercial conditions for the contract to be implemented. In evaluating and selecting bids, predefined criteria should be used; the most important of these are prices and qualitative/technical specifications of products.

Also, Russian legislation provides for a closed bidding procedure for procurement in the limited competition markets and a two-stage bidding procedure for procurement of scientific research or complex unique works. Shopping is an appropriate method for procuring readily available off-the-shelf goods or standard specification commodities of relatively small value. In case procurement is contracted with a monopolist or if procurement is urgent, direct contracting (the single-source procurement method) is used.

Conflict of interest in public procurement

Generally speaking, conflict of interest can arise in situations where individual/private interests collide with official functions/responsibilities, as illustrated in the figure below:

Figure 8.2. Illustration of conflict of interest



According to World Bank rules, potential conflict of interest is one of the main factors determining the legal eligibility of bidders. The bidding firm has a conflict of interest if, for example, it is affiliated with another firm that was involved in the design or supervision of the project, and it therefore may not provide goods or works for the same project. Russian public procurement legislation does not directly prohibit situations of this kind.

Conflict of interest in public procurement can emerge not only at the individual/personal level, but also at the level of the organisation as a whole. Thus it can be clearly divided into "personal" and "corporate" or "institutional" types; each has its prerequisites for conflict and its manifestations.

Prerequisites for personal conflict of interest:

1. A willed lack of transparency.
2. Some official functions involve decision-making based on subjective (personal) appraisals.

3. Imperfect accounting, monitoring and audit system.
4. Lack of regulations to settle emerging conflicts of interest.

Prerequisites for corporate conflict of interest:

1. Differing objectives of a public office/department and the state because of misunderstandings or inaccurate/ambiguous formulation of departmental tasks.
2. Short-term plans for organisation prevailing over long-term ones.
3. Imperfect legislative, monitoring and audit systems.

Basically, manifestations of personal conflict of interest in public procurement are similar to those of conflict of interest in public service as a whole. Typical manifestations of personal conflict of interest in public service are listed by Canadian political scientists Ken Kernaghan and John Langford in their book, *The Responsible Public Servant*:

- Influence peddling.
- Use of confidential information.
- Outside employment or moonlighting.
- Using the property of one's employer's for private advantage.
- Self-dealing.
- Post-employment.
- Accepting benefits.

Possible corporate manifestations include:

- Ineffective spending of public funds.
- Administrative support of specific suppliers or their groups.

Box 8.1. Examples of "corporate" and "institutional" conflict of interest

1) A ministry/department has direct financing for procurement of specialised equipment in the amount of RUB 20 million. The equipment was to be procured in October, when the necessary premises for it would be ready. In the first half of the year prices for the required equipment went down by 15-20% due to new companies producing equipment of the same kind. There were thus savings on the budget item, because quantitative or qualitative alterations of the procured goods were impossible due to functional and space limitations. The savings amounted to RUB 3-4 million. Due to strict finance laws it is impossible to turn those funds to any other budget items: the funds have to be returned to the budget. Returning them, however, would most likely lead to scaling down the budget of the ministry/department in the next financial year. A conflict of interest thus arises, because the ministry/department is not interested in efficient spending of assigned funds.

2) The regional/municipal administration procures goods via open bidding. Bidders come from that region and neighbouring regions. In case a bidder from a neighbouring region is awarded the bidding for having the lowest price, funds will be saved – but taxes will go to the neighbouring region's budget, and the regional/municipal administration will not receive the full amount of budget returns. It will then not be able to finance its other needs. Apart from that, any local administration is interested in keeping and maintaining employment in its region. Thus, the regional/municipal administration is interested in awarding contracts to a "local" supplier (bidder), a conflict of interest situation.

Conflict of interest in the process of public procurement

Conflict of interest in public procurement can be viewed from different standpoints. The two examined here are sources of origin and bidding stages.

By source of origin

Conflict of interest by source of origin could be classified as follows:

1. Conflict of interest of the public purchaser operating as bidding manager.
2. Conflict of interest of the public purchaser, not operating as bidding manager.
3. Conflict of interest of a third-party bidding manager.
4. Conflict of interest of bidder/bidders.

Here it should be noted that the public purchaser and bidding manager are not always the same person. That is to say, the bidding manager is "…Public Purchaser in the person of federal executive authority as well as a legal entity to which the Public Purchaser has handed over part of his bidding administration functions" (Legal ground: Article 2, Federal Law of the Russian Federation "On Public Procurement of Goods, Works, Services" No. 97-FZ, 6 May 1999).

Conflict of interest of public purchaser (operating as bidding manager)

In cases where the public purchaser does not hand over the bidding manager's functions to a third party, they carry out the work and are fully responsible for the procurement process. That process includes, inter alia: elaboration of the "internal" normative base, finance and economic planning, working up bidding documents, performing all necessary procedures and producing all necessary papers and reports. Thus for the public purchaser, every possible prerequisite for personal and corporate conflict of interest is in place. Owing to the lack of precise regulation with regard to potential conflict of interest, public purchaser personnel a priori find themselves in a situation where they may be accused of corrupt practices. Moreover, they have little chance to prove the legislative/formal competence of their actions in a conflict of interest situation.

Conflict of interest of public purchaser (not operating as bidding manager)

When the public purchaser hands over some of their functions to a third party, they normally specify time of delivery and the nature of the procured goods, works or services, and award a contract as a result of the bidding process. As an option the public purchaser can also form a bidding commission from among their personnel. The commission may consist of the bidding manager's personnel as well. Thus the public purchaser, along with handing over functions and authority, hands over many "corruption opportunities" to the bidding manager. In that case the prerequisites for personal conflict of interest are fewer in number; however, the complete set of risks with regard to corporate conflict of interest remains.

Conflict of interest of a third party – bidding manager

The bidding manager on the commission of public purchaser arranges and conducts bidding procedures, while the evaluation of bids and final decision is up to the bidding commission, which may consist of both the public purchaser's personnel and that of the bidding manager. In this case both types of conflict of interest are possible. Mostly, the

public purchaser's corporate or personal interest furnishes the prerequisite for the bidding manager's corporate conflict of interest. The bidding manager has to follow direct orders or unofficial requests from public purchaser so as not to be viewed as "intractable" and thus lose existing or future contracts for this or other public purchasers. At the same time, the bidding manager's personnel may have their own interest in the results of the bidding, which may lead to personal conflict of interest.

Conflict of interest of bidder(s)

Conflict of interest of the bidder(s) is a special topic. In this case too there are situations of personal and corporate conflict of interest. Prerequisites and manifestations of personal conflict of interest are identical to those of the public officer; the only difference is the fact that personal interest may be aimed at "helping" a competing company bidding for the same contract. Corporate conflicts of interest mostly arise when suppliers conclude an illegal cartel agreement to bid for a specific contract or when development of a market segment is stimulated. Emerging conflict of interest is concerned with the inevitable contradiction between a bidder's desire to obtain a profitable contract and the need to observe the agreement with other parties of the cartel.

By bidding stages

Table 8.1. Conflict of interest by bidding stages

	BIDDING STAGES	Sources of conflict of interest	Examples
1.	Identification of needs	Public purchaser	Substantiation of a need adjusted for "own" interest.
2.	Preparations for bidding	Public purchaser, bidding manager	*Bidding manager:* preparing specifications adjusted for "own" bidders. *Public purchaser:* correcting specifications adjusted for "own" bidders.
3.	Invitation to bid	Bidding manager	Simulating information and placing administrative barriers in "wrong" ("alien") bidders' way.
4.	Preparation of bids	Public purchaser, bidding manager, bidder	*Public purchaser:* correcting bidding documents to suit "own" bidder's interest. *Bidding manager:* giving "own" bidders access to confidential information. *Bidder:* concluding conference agreement with other bidders.
5.	Submission/admission of bids	Public purchaser, bidding manager, bidder	*Public purchaser:* alteration of bids admission deadline without notification to "wrong" ("alien") bidders. *Bidder:* deliberately late submission of bid.
6.	Evaluation of bids and selecting the bid for award	Public purchaser, bidding manager	*Public purchaser:* juggling with evaluation criteria and their weighted values. *Bidding manager:* "loss" of some documents of "wrong" ("alien") bid.
7.	Award of contract	Public purchaser	Forcing the awarded bidder to waive signing of contract.

How to legally regulate a conflict of interest in procurement?

The only document dealing with conflicts of interest in public procurement is the Law of the Russian Federation "On Competition and Restriction of Monopolistic Activities in the Goods Markets" No. 948-1, 22 March 1991 (edition of Laws of the Russian Federation No. 3119-1, 24 June 1992, No. 3310-1, 15 July 1992; Federal Acts No. 83-FZ, 25 May 1995; No. 70-FZ, 6 May 1998; No. 3-FZ, 2 January 2000; No. 196-FZ, 30 December 2001; No. 31-FZ, 21 March 2002; No. 122-FZ, 9 October 2002). In particular, Article 9 of the Law reads:

Antimonopoly requirements to public procurement of goods, works, services

1. Procurement procedures do not allow:
   - Arranging privileged bidding conditions including access to confidential information, reduction of bidding payment, for specific bidders.
   - That bidding managers, their personnel and affiliated persons bid.
   - That the bidding manager coordinate bidders' activities which result or may result in restrained competition between bidders or infringement of bidders' interests.
   - Unwarranted restricted admission to bidding.
2. Breach of the provisions of the present article warrants bidding to be adjudicated invalid by Court.

Control of conflict of interest in public procurement

In international practice the question of controlling/preventing conflicts of interest is considered one of the key elements of an anti-corruption strategy for public officials. The OECD Guidelines for Managing Conflict of Interest in the Public Service provide an international reference for reviewing existing arrangements and developing new policy and practice.

Mechanisms to control personal conflicts of interest are rather developed, both abroad and in large Russian commercial corporations. These consist of carrying out a number of "internal" research efforts aimed at identifying the eventual scope of conflicts of interest, policy and procedures for detecting and considering them, mechanisms for receiving notices/information about them, and measures to settle an actual or eventual conflict of interest. Normally, research results are to be published in an official document – "Code of Conduct for Procurement Personnel". If this document also includes mechanisms to control personal conflicts for the other activities, it is commonly called the "Ethics Code". Once the Code has been developed the main objective of the company is to monitor personnel to ensure they observe the Code and make corrections in order to increase its relevance.

The problem of the control of corporate conflicts of interest is ambiguous. To eliminate the prerequisites, the State needs to seriously revise the function of ministries and public offices and in addition establish a conciliatory authority that will efficiently settle existing contradictions and study the scope of potential institutional conflicts of interest, and areas where they may arise.

Chapter 9

The Role of Transparency in Preventing Corruption in Public Procurement: Issues for Consideration

by

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This paper provides an overview of the pertinent issues in considering the role of transparency in preventing corruption in public procurement. It describes ways to increase transparency at all stages of the procurement process and highlights problem areas related to information disclosure. The paper also outlines the role of new technologies in fostering transparency and raises questions on specific points for reflection and discussion.

Corruption is most likely to occur in a situation where agents enjoy discretionary power over the provision of goods or services and a low level of accountability. Therefore, information plays a crucial role and transparency is a major tool for preventing corruption and ensuring accountability of public officials.

The importance of transparency for preventing corruption

Transparency is an integral part of good governance, and together with accountability and control, helps ensure integrity, efficiency, and fair and equal treatment of providers in the procurement process. Transparency, in the context of public procurement, refers to the right and ability of all interested participants in the process to know and understand the actual means and processes by which contracts are awarded and managed. In a transparent environment, citizens and businesses can scrutinise how public procurement officials exercise their authority.

Transparency requires the release of sufficient information to allow the average participant to know how the system is intended to work as well as how it is actually functioning. This includes all procedural provisions, such as regulations and laws concerning the process, the institutions and persons involved, the tender documents, etc. Precise rules, standardised tender documents and clearly defined procedures support transparency by making information accessible and understandable.

Transparency allows competing private enterprises to evaluate the framework of doing business with the government. Moreover, private enterprises can make more realistic economic investment decisions when government procurement policies are in line with good commercial practice and public accountability requirements. A transparent procurement system also creates a greater awareness of the proper use of public funds, helps enhance the public sector's image and generates confidence among civil society. Increased transparency in developing countries raises donors' confidence and helps attract higher foreign direct investment. Therefore, transparency can make a contribution to long-term economic growth and sustainable development.

Accessibility of information

In practice, transparency means access to information on laws and procedures as well as on specific procurement opportunities. This is particularly true in diverse public sector marketplaces where finding procurement opportunities can be difficult, time consuming and expensive for firms. Easier access to procurement opportunities across government is beneficial for the whole economy. In particular, public sector participants should be able to:

- Make procurement opportunities accessible to a wide range of potential suppliers.
- Give private sector suppliers the information they need at the right time and in the right form. This requires the understanding of the markets in which public

tenders operate and what the markets can do to achieve specific government objectives through public procurement.

- Recognise that industry is looking for predictable demands, and assurances that these demands will actually turn into real orders.
- Acknowledge the importance of an open dialogue for successful delivery, and initiating it at an early stage.

However, full transparency may also enable bidding cartels to detect and make use of defects in specific bidding cases. As indicated in the findings of the 1999 OECD Best Practices Roundtable on Competition Policy and Procurement Markets, there may be trade-offs between controlling collusion and controlling corruption. It may be possible to control corruption and favouritism without full transparency by limiting disclosure to designated procurement-oversight agencies that effectively monitor cases.

What level of transparency at what stage?

Consistent application of transparency throughout the whole procurement process is crucial, since lack of transparency at one stage can endanger the integrity of the whole process. The second workshop therefore took a comprehensive approach and reviewed emerging standards and practices applied to promote transparency in the three phases of public procurement procedures, namely in:

- The definition of needs.
- The bidding process.
- The post-award, contract management phase.

In the award process, for instance, transparency requires the release of information on successful bids and, of equal importance, providing information to unsuccessful bidders on the reasons why they were not selected. Being open and responsive during the process can also help prevent problems and protests later on, and preserve good business relationships for future procurement needs.

Causes of insufficient transparency

Factors that result in a low level of transparency include:

- Lack of government attention or resources to invest in establishing a transparent procurement regime.
- Motivation on the part of a government agency to circumvent a non-discrimination rule.
- Self-interest of government officials.

Examples of malpractice that violate the principle of transparency include:

- Insufficient publicity of the tender.
- Vague or unclear pre-qualification requirements.
- The absence of a record of, or secure access to bids.
- Lack of oversight and insufficient reporting requirements at the contracting phase.

Incentives for transparency

The reliability of information can be increased by a combination of proper incentives and disincentives. Appropriate information, such as correct cost estimates, is rewarded while incorrect information is penalised.

In the private sector, price mechanisms and competition also support accountability. An accountable project organisation ensures that the bidding organisation and its management are responsible for avoiding misinformation, cost overrun, benefit shortfalls and faulty design.

Dialogue with stakeholders

Transparency and accountability can be achieved when relevant stakeholders are actively engaged in the course of the public procurement process. There is wide scope for involvement of the private sector and civil society, for example in the form of public hearings and independent forecast reviews. Civil society plays a significant role as a source for defining needs and requirements in consultations, and as a watchdog for evaluating service delivery and providing feedback on the ultimate outcome of procurement.

The private sector, largely composed of suppliers, contractors and consultants, can provide information on state-of-the art solutions in their field, as well as on difficulties and loopholes in the policies and procedures, based on their practical experience.

As the UK experience shows, the public sector also needs to take a much more systematic and strategic approach to the markets in which it operates, and not just manage individual procurements. Findings from the Kelly Report[1] show that there is a need for a greater exchange of information between different government departments and other parts of the public sector than generally took place in the past. An example of emerging good practice is bid conferences, attended by both procurement officers and industry representatives, to discuss and exchange points of view on procurement approaches and requirements in a sector before tender submission as well as after the tender invitation. The need for closer co-ordination within the government sector is further reflected in the new EC Directives (*e.g.* through framework agreements and central purchasing bodies) as is the possibility to establish a dialogue with tenderers during the tendering process.

Balancing the need for access to information with privacy

Information in the public procurement process can be classified as:

- Public information – including general information on laws, procedures such as tendering documents, as well as specific information on the criteria applied in deciding a particular procurement case.
- Commercially sensitive information – such as on knowledge of technical solutions, know-how, technical and management capacity included in the bidding proposals.
- Information related to private information of participants in the procurement process either in the public or the private sector.

It is obvious that the more bidders know about a customer's requirements, selection criteria and the environment in which the system will operate, the better they can design a

solution to meet those requirements. Governments penalise themselves when they withhold information that might materially affect project design and decisions made by a bidder.

However, there are situations where the private sector participant also has an interest in having the commercially sensitive information protected. For instance, the proposal could contain the bidder's proposed technical solution in functional terms, management approach, and cost. Therefore, it is important that proposals be treated carefully by governments to ensure that such sensitive information is not released to competitors.

Another difficult question is, for example, how to obtain information systematically on the performance of individual suppliers and advisers, while using information already held on supplier performance to determine the type of information to be sought from bidders. Under EU Directives, information on technical capacity that can be required from candidates in procurement includes evidence of performance under past contracts. If competition is to be truly effective, poor performance of one public sector contract would need to have repercussions on the chances of obtaining subsequent contracts. Ideally information would be shared across the whole public sector.

Providing information on private capacity interests of individuals involved in the decision-making becomes particularly relevant when such interests might improperly influence the performance of duties. However, protecting the privacy of individuals is a major concern in modern societies. For instance, the US Freedom of Information Act provides for exemptions for withholding at least such information as:

- Information about individuals when disclosure would constitute a clearly unwarranted invasion of personal privacy.
- Information compiled for law enforcement purposes if certain interests would be harmed by release, including when disclosure could reasonably be expected to interfere with enforcement proceedings or to constitute an unwarranted invasion of personal privacy.

It is in the interest of the general public that expenditures made through the public procurement system be economical, rational, and fair. In the process of deciding on allocations, governments are expected to protect the interests of the public. Business interests form part of this overall public interest, because the business community's ability to participate in the national procurement process contributes to assuring their viability as employers and productive economic units.

The crucial question in this context is how to strike a balance between the interests of all participants in the public procurement process: where should the line be drawn between the demand for ensuring transparency at all stages of the procurement process and the need to protect stakeholders' interests and the privacy of individuals involved?

Identifying and managing conflict of interest

Public procurement constitutes a meeting point of the public and private sector and their respective interests. Both sides may be tempted to divert some of the products or money involved in the process for personal use. An official in charge of public procurement may be influenced in performing his or her duties by private capacity interests, to the detriment of the interests of the general public. Providing information on and controlling private capacity interests of public officials is therefore crucial to ensure their impartiality in exercising their functions.

The OECD Guidelines on Managing Conflict of Interest in the Public Service[2] provide a unique international benchmark for developing and implementing a comprehensive conflict-of-interest policy. In specific cases public organisations and officials should ensure an appropriate degree of openness in the process of resolving or managing a conflict-of-interest situation, to enable scrutiny within the applicable legal framework.

A few OECD countries have developed a general definition in the law for the term "conflict of interest". Laws or policies enumerate a variety of circumstances that are regarded as creating conflicts of interest. For instance, in New Zealand the Audit Office developed specific *Good Practice for Purchasing by Government Departments* guidelines that also set out the standards for identification and management of conflict of interest in the procurement process. In general, cases are examined with the management of the department. However, a Parliamentary Select Committee may also review cases with departments.

Reaping the benefit of e-procurement

E-government refers to the use of new technologies by the government in fulfilling its functions. The application of information technology by the administration is considered a viable means for solving several problems. Most importantly, e-government allows governments to reorganise procedures, make information accessible and reduce costs.

Procurement of goods through the Internet or an Information and Communication Technologies-based process (e-procurement) is emerging worldwide with the potential to standardise processes, increase their transparency, improve access to markets, and promote integrity in public bidding. E-procurement has thus become a major tool for promoting transparency and reducing corruption, while at the same time fuelling demand for state-of-the-art technology. Efficiency needs are a driving force for e-procurement, but so are increased transparency and competition among suppliers. E-procurement drastically reduces the cost of information – particularly in developing countries – while at the same time facilitating its accessibility.

In the broadest sense, e-procurement has been used in the establishment of contracts, but it increasingly also covers publication of tenders, ordering, invoicing and payment. Computerisation of procurement processes can improve efficiency and effectiveness and remove opportunities for corruption. Well-designed and implemented systems can minimise unnecessary face-to-face contact and reduce opportunities for the improper exercise of discretion.

E-procurement is also a means of standardising processes and making information available, thus enabling the control of discretion through benchmarking. Decisions become comparable, which allows for internal control and the tracking of deviations from normal practice. Moreover, automated systems can also be configured in such a way as to allow monitoring and maximising of the level of accountability. They also provide a reliable audit trail for later evaluation and review. Automation can be used to eliminate the most vulnerable points in manual systems. It is unlikely, however, that e-procurement can contribute to the anti-corruption effort if it is not combined with other reform measures, particularly in the procurement agencies.

In Brazil, for instance, one of the major benefits of the introduction of an electronic procurement system by the Brazilian Federal Government was increased transparency. Information and services available at COMPRASNET include tender results, contract

statements, e-mail by interest profile/ preference list, a specialised forum and a payment gateway. Electronic price quoting (e-shopping), information on tender announcements, an inverse auctions agenda, reverse auctions under way, and reverse auctions results are, among others, examples of transparency that foster public scrutiny over this procurement system.

A pilot interactive database, set up by the International Trade Centre (ITC), the *Compendium of Public Procurement Systems*[3], enables a country to compare its procurement system with those of other countries and with generally accepted models. ITC is seeking to partner with countries and other international organisations to expand the number of countries in the compendium.

While the introduction of e-procurement is assumed to have a positive impact, it is difficult to quantify the actual benefit. However, more and more governments are requesting that the benefits of such investments be demonstrated and that business cases be developed. The European Commission has initiated online consultation aimed at identifying opportunities and challenges in electronic public procurement. The consultation, launched in September 2004, will provide the Commission with input from businesses on existing barriers, expectations and challenges in electronic procurement. This will enable the Commission to issue an Action Plan which will help Member States remove obstacles to electronic public procurement, increase efficiency and modernise public procurement markets.

Questions on the role of transparency in preventing corruption in public procurement

What level of transparency is required at the different stages of public procurement procedures (e.g. providing information on the criteria for decision-making, results of the decision and details of the process, such as when the decision was taken and by whom)?
What type of information should be made accessible to the public and what information should be considered private and therefore be protected?
What incentives work to ensure transparency and accountability in procurement procedures, in particular in the definition of needs and in the post-award process?
What are the major challenges related to the close interaction with businesses, and how can they be addressed?
What are the experiences of stakeholders in involving the private sector and civil society in the public procurement processes?
What specific measures work well in ensuring the timely identification and disclosure of conflicting private-capacity interests of officials participating in public procurement?
What remedies are available when procurement decisions are influenced by private interests of public officials?
How successful have e-procurement strategies and practices been in improving transparency and reducing corruption?
What are the limits (and/or failures) of e-procurement strategies?

Notes

1 Office of Government Commerce Report to the Chancellor of the Exchequer (2003): *Increasing Competition and Improving Long-Term Capacity Planning in the Government Market Place*, http://www.ogc.gov.uk/embedded_object.asp?docid=1001394 .

2 The Guidelines were approved in the form of a Recommendation by the OECD Council in June 2003. The Guidelines and the Toolkit can be consulted at http://www.oecd.org/gov/ethics .

3 The compendium may be consulted on the ITC web site http://e-pubpro.com/compendium/ .

Chapter 10

Republic of Korea: The Potential of E-Procurement

by

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In Korea, the adoption of digitalisation in government procurement has greatly enhanced transparency and achieved remarkable anti-corruption effects.

The Korean government's anti-corruption efforts

There was a need to shift from traditional audit and inspection (*i.e.* detection and punishment) to a more systematic approach of preventing corruption. Thus, Korea has employed several different strategies, such as adopting international rules, improving systems, utilising information technology (IT) and transforming mindsets through training and promotion.

These efforts began with measures to combat corruption generally. Korea enacted the Public Service Ethics Act in 1983, which was followed by the Public Institutions' Information Disclosure Act in 1996.

In 1999 the country joined the OECD Convention on "Combating Bribery of Foreign Public Officials in International Business Transactions". The Corrupt and Illegal Practices Prevention Act was established in 2001, and the following year saw the launch of the Korea Independent Commission Against Corruption – a milestone in the eradication of corruption.

Since February 2003, Korea has enforced the Code of Conduct for Safeguarding the Integrity of Public Officials.

Turning to procurement specifically, this is a complex area in which there are fierce conflicts of interest among businesses. Controversy, disputes, civil complaints and misunderstandings can quickly arise. Loopholes in the procurement system – such as the exclusion of competition, excessive arbitrary decision-making, information asymmetry, lack of accountability and transparency – can easily lead to corruption.

In order to overcome these problems, Korea joined the WTO Agreement on Government Procurement in 1997, which allowed the opening of government procurement markets to WTO member countries. Korea also strived to raise transparency to an international level by adopting international rules on government procurement.

In particular, the Public Procurement Service (PPS) has operated an Integrity Pact for all contracts since 2001. The purpose of this pact is to make the private sector aware that business values originate from business ethics, and to encourage them to join the anti-corruption campaign.

The pact requires that businesses and contract officials pledge not to solicit or provide gratuities or entertainment with a view to procurement. In addition, the survey questionnaire of the pact is conducted twice a year, and the results are disclosed to the public.

Since 2002, the PPS has also operated the Procurement Committee for Integrity, a co-operative body bridging the private and public sectors that comprises civic groups, university professors and business specialists. This committee offers the PPS advice on improving the procurement system; its input has led to increased fairness in contracting.

In its efforts to prevent corruption, the PPS has adopted IT – a move that has significantly enhanced transparency in the public procurement market. The section below discusses the anti-corruption effects of e-procurement.

Korea's e-procurement system

It is important to keep in mind the immensity of Korea's procurement market.

The country has adopted a centralised procurement system in which national organisations must purchase their needs through the PPS above a certain threshold or amount; state-owned enterprises can, in principle, procure on their own. In 2003 the entire public procurement market amounted to approximately USD 67 billion. The PPS accounted for around 30% of that figure; it was in charge of contracting for goods and services valued at USD 7 billion and public works valued at USD 12 billion.

The PPS started EDI in 1997 in order to process some 4 million documents a year that were exchanged between public institutions, the PPS and businesses electronically. In 2002 PPS established the Government e-Procurement System (GePS) for joint use with all public organisations.

The major functions of GePS

First, as a single window in procurement, GePS provides integrated bidding information for all public institutions and enables businesses to participate in all biddings with just a one-time registration.

Second, GePS enables electronic processing of the entire procurement process – from purchase request, bidding invitation and registration to bidding, contracting, inspection and finally payment.

Third, since GePS is linked with 53 other institutions such as government and financial institutions and relevant associations, it provides a one-stop service for customers. The sharing of information has eliminated or significantly reduced the amount of administrative paperwork.

Finally, GePS is a ubiquitous e-procurement system accessible through mobile phones and PDAs. GePS provides customised information, including commodities, suppliers and market situations on the basis of customer relationship management (CRM). It also operates a wireless electronic bidding system.

Major achievements of GePS

First, GePS is the world's largest cyber market, in which approximately 30 000 public institutions procure needs valued at USD 3 billion annually from 110 000 businesses. Its Web site records hits from 80 000 people daily. Some 160 000 documents are exchanged every day through the site. The GePS shopping mall provides public institutions with office supplies valued at USD 4 billion.

Second, real-time disclosure for all procurement information and online processing of procurement work has significantly enhanced transparency and eliminated the need for businesses to visit public institutions.

E-procurement has reduced petty corruption, a form of bureaucratic corruption, as doing away with face-to-face contact prevents the causes of and opportunities for corruption at the source.

Third, thanks to the convenience of e-procurement, competition in this market has significantly increased. The number of participants in competitive biddings has grown threefold, and a great number of micro purchases for private contracts have converted.

Fourth, e-procurement has made the process much more efficient. This has led to savings of approximately USD 3 billion annually thanks to the acquisition of integrated bidding information by all public institutions, a one-time registration with GePS, e-bidding through the Internet, online transfer of payment and the reduction in paperwork.

As a result of this innovation in e-procurement, PPS was presented with the Public Service Award in June 2003 from the UN, and in May 2004 received an assessment from the OECD which stated that e-procurement does not require any further action.

The success factors of GePS

First, 65% of the Korean population – or 30 million people – are using the Internet, and 75% of all Korean households – 11 million households – are connected to broadband. This indicates that Korea has the best Internet infrastructure in the world.

In addition, the E-Government Special Committee under the president pursued an e-procurement project; GePS thus gained strong political support.

Furthermore, based on 50 years of professional expertise as a central procuring agency, PPS has consistently pursued digitalisation in order to customise procurement services.

Conclusion

Currently, many countries are trying to save social costs by preventing corruption in government procurement. They are also attempting to realign relevant regulations, involve professional organisations and strengthen ethics in order to enhance national competitiveness.

Korea's experience demonstrates that a more systematic approach using IT can be one of the most effective policy tools. Proper adoption of an e-procurement system can expand transparency in the international procurement market and contribute to the prevention of corruption.

Chapter 11

Mexico: Lessons Learned in Promoting Transparency

by

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Measures to introduce elements of transparency into Mexico's public procurement system began with the previous administration's launching of Compranet, a Web site designed to display information procurement information. When President Fox came into office, the Ministry of public Administration commissioned a study into areas in government subject to corruption. The results pointed heavily to purchasing as a most critical area, inside and outside of government.

Resolving that issue thus became a key priority, both in the government's reform agenda and in its programme to fight corruption and build a culture of integrity and transparency in Mexico.

Over the past four years the government has improved Compranet's effectiveness, but it has also worked to make the entire purchasing system more transparent and efficient. One of the lessons learned from working with Compranet is:

> *Transparency of information may be the single most important tool to deter corruption – but it is not, in itself, enough to guarantee the transparency of the purchasing process.*

Changing a system requires taking a look at the whole process, revising existing legislation and strengthening ethical guidelines and controls for those who manage that system.

Thanks to the use of information technologies, the system today is more user-friendly; anyone can access Compranet and obtain information on what is contracted by federal government institutions, when, where, at what price and to whom the contracts are awarded. Web users can be present at and follow up on public biddings without leaving their office. Compranet receives 20 500 visits every day, and 7 000 terms of tender are solicited and obtained through the system. Bids representing 60% of the government's purchasing budget are submitted electronically via Compranet; by the end of 2005 that figure will reach 100%.

The system has also been improved in terms of the evaluation of bids, formalisation and administration of contracts, and on-site delivery of goods and services. Furthermore the government, in a parallel measure to prevent wide price variations in federal purchasing, has facilitated price consultations. It has also brought into effect measures to prevent collusion between authorities and users.

Meanwhile, the public's participation in overseeing the transparency of public procurement has increased. The government has signed co-operation agreements with universities, representatives of chambers of commerce, business organisations and NGOs to ensure their participation in various stages of the procurement process. At some point however, with revised legislation it will no longer be necessary to have public observers in order to guarantee transparency of the bidding processes.

As this administration came into office, it heard frequent complaints about the rigid, discretionary and opaque nature of the existing laws on procurement and public works. In the year 2002, the Ministry of Federal Comptrollership and Administrative Development (today known as the Ministry of Public Administration) set itself the task of revising these laws. It asked a highly regarded academic institution to identify best practices in government procurement internationally, and to carry out a comparative study with existing procurement legislation in Mexico.

A wide consultation process was undertaken with federal agencies; chambers of commerce and business associations representing government suppliers; professional

associations; experts in transparency, accounting and electronic systems; state governments; and the general public. Another important lesson emerged:

> *Conflict of interest between purchasers and vendors is inevitable in every consultation process.*

Consensus on purchasing issues is very fragile because no reform can fully satisfy all actors involved.

The best practices and opinions that came to light provided the raw material for the draft reform bill that the government presented to Congress. The bill was approved in December 2002 by the Chamber of Deputies and sent to the Senate for its review and approval. As of this writing, the reform has not yet been approved, but is still under discussion.

Every promoter of a reform knows that they will encounter resistance and opposition to change; this reform was no exception. A lesson that emerged here, however, was that:

> *Reformers should abstain from introducing issues that can launch ideological debates.*

Multiple service contracts for the state-controlled gas and oil industry were such an issue, one that contaminated the lobbying process. It is now clear that the item should not have been included in the draft bill.

Half of the reforms included in the original draft bill were eliminated by the Senate; these included reverse auctions and the creation of an autonomous regulatory body for government procurement. However, the reform bill as it now stands contains noteworthy benefits:

- Bids will be simplified with a single-envelope, one-stage procedure.
- The participation of micro, small and medium-sized companies is being encouraged at no detriment to international commitments or to the effectiveness or efficiency of public funds management.
- The use of national inputs in public works is also being encouraged.
- Through the use of information technologies, discretionary powers of public officials in establishing the requirements of public tenders are being eliminated.
- Measures are being adopted to prevent companies or individuals ineligible under the law from participating in government contracts.

While the government continues to lobby for the approval of the reform bill as it now stands, it also promotes additional measures to strengthen the transparency and efficiency of the procurement process. Outstanding among these are:

1. A World Bank ruling stipulating, first, that all World Bank-financed tenders are to be conducted through Compranet and, second, that in the near future all tenders will need to comply only with Mexican legislation and not with regulations issued by the Bank. Also, the Bank's decision to certify Compranet for all their bidding processes is a change now applied to the hiring of outside auditors: whereas in the past their hiring was decided by appointment, today they need to participate in a bid by invitation. It is hoped that this mode will be extended to the contracting of outside lawyers as well.

2. The review of the terms of a tender prior to its issuance, with the participation of experts, chambers of commerce, business associations and other interested parties, in order to prevent predefining in contracting.

3. Formulation of standard terms of tender.

4. Formulation of risk maps in government contracting and the establishment of control measures (see also Chapter 24 on identifying risks in the bidding process in Mexico).

5. The promotion of codes of conduct and integrity programmes within government institutions and among government suppliers.

6. The ministry of public administration has ordered that terms of tender include a clause on the principal guidelines of the OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions. This is part of a wider campaign, in compliance with the OECD Convention, to make suppliers aware of the implications of bribing public officials; to inform them that bribery is prohibited and penalised by Mexican law; and to prompt their awareness of the existence of preventive tools against corruption, such as integrity programmes and codes of conduct.

7. The signing of all international anti-corruption conventions – those of the OAS, the OECD, the UN – and a strong commitment to lead the way in their compliance.

A final lesson could summarise:

> *If purchasing reform is to be successful, it needs to undergo continuous evaluation.*

No reform will be complete without envisaging personnel control systems that eliminate conflicts of interest, that monitor wealth levels of public employees, and that give government sufficient authority to act upon findings of unaccountable wealth. It also needs to envisage adequate witness protection schemes, an issue that Mexico is only beginning to tackle now.

Another major challenge facing us all is the need to open the international banking system, to make it more flexible, in order to facilitate bribery investigations in public procurement. Even the most perfect of systems will fail if bribery money finds its way into foreign accounts.

Part II.B

Ensuring Accountability: Designing and Controlling Sound Procurement Procedures

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Chapter 14	Ensuring Accountability in Public Procurement: Bridging Information Asymmetry Peter Trepte Barrister, Littleton Chambers, London, United Kingdom
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Chapter 17	China: Legislating Anti-Corruption Measures in Government Procurement Yu An Professor of Law, School of Public Policy and Management Tsinghua University, People's Republic of China
Chapter 18	Hungary: Establishing Control Mechanisms in Contract Award Procedures András Nagy Legal Adviser, International Relations Department, Council for Public Procurement, Hungary
Chapter 19	Poland: How The New Law on Public Procurement Implements the Anti-Corruption Recommendations of The Supreme Chamber of Control Alina Hussein Adviser to the President, Supreme Chamber of Control, Poland

Chapter 12

Main Findings of the Forum Workshop on "Designing and Controlling Sound Procurement Procedures to Ensure Accountability"

by

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Introduction

This workshop reviewed approaches for developing a high-quality regulatory environment and ensuring its sound implementation to keep officials and suppliers in public procurement accountable.

In the last two decades, public procurement regulations have proliferated at both international and national levels, fostering the transparency of procurement procedures and creating a level playing field between suppliers. Presentations of national experiences in China, Hungary and Poland highlighted these efforts to develop consistent legal, institutional and procedural frameworks in public procurement. All participants expressed the shared policy goal of ensuring sound implementation and compliance with regulations through accountability and control mechanisms.

However, the principal objective of public procurement systems is to deliver efficiency and "value for money" in the use of public funds whilst adhering to the fundamental principles guiding government actions, in particular transparency and non-discrimination. Discussions indicated a growing awareness that public procurement rules, while they may reduce the number of opportunities for corruption, cannot eliminate them. In recent years, some OECD countries have begun to simplify their procedures after realising that additional regulations did not necessarily prevent corruption and could even hinder the efficiency of the procurement function.

Increasing efforts have also been made worldwide to prevent corruption by providing procurement officials with appropriate skills, professional capacity and incentives to help them identify and manage risks for corruption. Procurement officials have been given more flexibility in managing procurements, while being held kept accountable for their actions through the strengthening of accountability and control mechanisms.

Developing sound public procurement regulations and procedures

Participants recognised the increasing role of multinational trade arrangements like the World Trade Organisation's (WTO) Government Procurement Agreement, and the European Union (EU) Procurement Directives, in setting legal obligations for national procurement systems and practices to ensure the transparency of procurement procedures and an equal access to business opportunities for suppliers.

International rules: WTO and EU Directives

The WTO Agreement on Government Procurement is designed to make laws, regulations, procedures and practices regarding government procurement more transparent and to ensure they do not protect domestic products or suppliers, or discriminate against foreign products or suppliers. Similarly, the European Community has coordinated procurement procedures through two Directives covering works contracts, supply contracts, service contracts and "utilities" in the sectors of water, energy, transport and telecommunications. For public contracts with an estimated value above certain thresholds, European directives establish common rules for advertising procurement needs, invitations to tender and contract award (*e.g.* transparency of rules and selection criteria, need to justify award decision). These rules are based on the principles of non-discrimination on the basis of nationality for EU firms, free competition and transparency of award procedures. In addition, the 1989 and 1992 Review Procedures Directives aim to guarantee a proper remedy for an infringement during contract-award

procedures[1]. Since problems have been identified in this area such as the availability and effectiveness of remedies before contract signature and the damages available after contract signature, the European Commission is currently exploring ways to improve review mechanisms.

The role of governments

Governments remain the main actors for developing a regulatory framework that favours equal opportunities to access the procurement market as well as ensuring the accountability of the bidding process. Regulations, in general, call for "full and open competition", which gives all responsible sources the opportunity to submit offers to perform government contracts. However, some participants noted that the political process may require restricted competitions to take place or decisions to be taken where obtaining the best value for money is secondary to achieving higher national goals (*e.g.* favouring small businesses or a selected company which is important for national interests). In this case, governments need to justify and explain the reasons for the decision in a transparent way, and to demonstrate the benefits and costs of this non-competitive approach.

Several speakers highlighted current efforts in their countries to develop procedures that ensure that the bidding process is open to public examination and review. For instance, in Poland, the new Law on Public Procurement in 2004 stipulates that procurement contracts shall be open and shall be made accessible pursuant to rules laid down in the provisions concerning public information. China also adopted a Government Procurement Law in 2003 as well as a series of regulations in 2004 on bidding of goods and services, information disclosure and handling suppliers' complaints in government procurement. In most countries review mechanisms include a complaint to procurement officials, followed by an action before an administrative body (either hierarchical or independent) and judicial review. Discussions indicated the need to provide stakeholders with an opportunity to draw attention to shortcomings of the public procurement system, before award through protest and after award through dispute systems.

The supporting organisational structure

The choice of organisational structure for a procurement system depends on countries' circumstances and market conditions, and therefore no standard approach or model can be recommended. In most OECD countries, there has been a tradition of centralised procurement followed by a gradual decentralisation of these procedures for a fairly extended period. A noteworthy example today is the Office of Federal Procurement Policy in the United States, a centralised procurement organisational structure that provides strategic focus and policy development and vests purchasing authority at agency level.

However, the experience of transition countries in Central and Eastern Europe has shown that moving from central monopoly state procurement systems during the communist era towards market economy-based procurement systems required the availability of a strong focal point within the government structure through the establishment of public procurement offices that are not responsible for actual purchasing but set national policy and support the implementation of procurement regulations. There is a range of organisational strategies available – from centralised to decentralised – for transition countries that aim to develop sound procurement organisations and procedures.

An appropriate mix is to be determined depending on the country's legal, administrative and economic context.

From policy to practice

Regulations provide a framework for fostering transparency and accountability in public procurement but, in practice, they can be easily bypassed. They will reduce the opportunities for corruption, but will not eliminate them. A leading empirical study conducted among businesses in Norway about corruption in international business transactions showed that 55% of respondents believed that public procurement regulations did not prevent corruption[2].

Increasing flexibility

Some participants agreed that additional regulations do not necessarily prevent corruption and instead could even hinder the efficiency of the procurement function. Public procurement regulations should not seek to remove discretionary power from public officials, but to ensure appropriate decision-making structures and control mechanisms. Regulations provide a framework for individuals to exercise their professional judgment while overseeing their discretionary power. Public procurement systems in most OECD countries have moved increasingly from a situation where public procurement officers are expected to comply with rules to a context where they are given more flexibility to achieve the wider goal of value for money.

In recent years, several OECD countries have established flexible regulatory frameworks and simplified procedures. For instance, the recent Federal Acquisition Streamlining Act in the United States has put emphasis on reducing regulatory constraints while keeping public procurement officials accountable for their actions. Efforts have also been made to harmonise and co-ordinate the legal, institutional and procedural frameworks in public procurement. For instance, the Office of Government Commerce in the United Kingdom is in charge of co-ordinating public procurement policies, mapping out good practices to achieve "best value for money" and drafting guidelines for public procurement officers.

Providing public officials with the right incentives and skills

There was a consensus that more effort should be put into providing procurement officers with appropriate skills, professional capacity and incentives to identify and manage risks for corruption. In transition countries in Central and Eastern Europe that have recently introduced public procurement regimes, this question is closely related to the implementation of the enacted procurement laws. More generally, public procurement officers increasingly play the role of project buyers, and they need to be more and more skilled to be able to make appropriate decisions in concrete situations.

Enhancing the professional independence of public procurement officials and shielding them from pressure of higher ranking politically designated officials was also recognised as key to ensuring the fairness of public decision-making. In this respect, managers act as a role model to commit to conflict-of-interest policies and communicate detailed information to employees concerning these policies. In addition, ethics training enhances public officials' professional skills and helps them find adequate solutions, particularly in risk and grey areas.

Ensuring the accountability of public officials and contractors

To balance the managerial discretion of procurement officers, governments have reinforced their accountability mechanisms. For instance, in the United States, public procurement officers prepare business cases for major capital acquisitions to justify their budget requests, and the business cases are reviewed in the agency by a multidisciplinary executive committee. Similarly, contractors are required to implement a performance measurement system in order to assess the cost, schedule, and performance status of the contract on a monthly basis.

Public procurement practices have also been adapted to help share risks in public procurement processes. For instance, from a very early stage in the process, an "Enquiry of Commercial Interest" can help investigate the private sector's ability to take over the project, establish a framework defining the preconditions and obligations for a private investor's realisation of the project and develop a realistic "model" for the distribution of risks involved between the public agent and the private investor.

Discussions emphasised the need to define in legal and procedural frameworks the financial and legal responsibilities of participants in the procurement process. Regulations might define the consequences for public officials of breaking public procurement rules, ranging from disciplinary measures to withdrawal from the participation in award decisions. Some participants mentioned the possibility of imposing financial penalties on the procurement entity or the agent for breaches of the public procurement law. In the case of bidders, an emerging practice has been to deny[3] access to the bid as a sanction for breaking the rules and a deterrent to corruption. This topic is further addressed in Part III in the section on "Compliance with anti-corruption laws through access to public procurement: Sanctioning or voluntary self-regulation".

The changing role of controls

As public procurement systems become more decentralised, one of the main difficulties is to co-ordinate the different forms of control in order to avoid gaps or overlaps and to maximise the use of information produced by these controls. To verify whether relevant regulations and standards are being met, public procurement operations are subject to many different controls: local controls, accounting controls, controls made by fiscal authorities, external controls and audits. Internal control is traditionally based on the separation of functions: programme officer responsible for public procurement in a specific field, contracting officer who manages the public procurement procedure, budget official and agency attorney for legal matters. Internal control systems have recently undergone substantial changes and are playing a crucial role in detecting irregularities and tracking systemic failures in public bidding. While in the past these regimes were heavily weighted toward process controls before spending, internal control now focuses mainly on results. External audit works together with internal control to ensure that the planning, budgeting and use of public resources is in line with a particular country's law and its government's objectives. OECD governments have strengthened internal controls and external audits to review public procurement decisions, make recommendations for standards or procedures that help eliminate loopholes in regulations, and provide a management overview of the public procurement function.

Notes

1 The EC Directives require national instances responsible for remedies to have the power to make available three main types of remedies: an injunction (interim measures and/or suspension) to prevent an infringement; the possibility of cancelling a particular procedure or award (including the right to remove unlawful specifications); and the provision of damages..

2 For further details, please refer in this report to the paper from Tina Soreide on Corruption in Public Procurement.

3 Reasons for denial may include: inadequate financial resources, unsatisfactory performance record, or unacceptable record of integrity and business ethics.

Chapter 13

Linking Islands of Integrity to Promote Good Governance in Public Procurement:

Issues for Consideration

by

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This paper attempts to go to the arguments and the methods for procurement control at the institutional design and legislative levels. It is based on, and uses in part, papers and discussions from the OECD Global Forum on Governance.

Government buyers are in the public eye because of the tremendous impact public procurement has on so many aspects of the social and business cultures and mores within a country. They must continually be aware of the influence of their actions and the responsibility they must shoulder to uphold the good of their country and its citizens. However, if the institutional underpinnings do not support honest and fair procurement actions, the virtuous civil servant can believe that he or she is a unique island of integrity in a sea of bureaucratic indifference to their personal and professional ethics.

Balance between Efficiency and Controls

Procurement operations and practices are at the core of a well functioning procurement system. Procuring entities must be held accountable for the responsibilities assigned to them. Officers of the Government who have been delegated procurement authority need to be made accountable for the public procurement decisions made by them. They represent the Government in an important interface with the public. They must be accountable for the effectiveness, efficiency, legal and ethical manner in which they conduct procurements.

Buyers should have the authority and encouragement to use personal initiative and sound business judgment on a daily basis. Additionally, the professional public buyer should employ knowledge of industry, trading principles and practices in an ethical manner to help set the tone of doing business within his or her national borders.

Identifying Good Practices

A growing number of OECD countries have established flexible regulatory frameworks and simplified procedures in recent years. The challenge for OECD countries has been to find solutions on how to harmonise the legal, institutional and procedural frameworks in public procurement while providing managers with sufficient flexibility. In addition, considering that flexible procurement systems imply a degree of uncertainty in control procedures, accountability practices have been evolving in order to verify whether relevant regulations and standards are being met. Coordinating different forms of control (local controls, accounting controls, controls made by fiscal authorities, external controls and audits) to fill-in gaps and maximise the use of information produced by different controls is a concern for OECD countries.

To obtain best value, quality and service, it is good procurement policy to encourage the most competitive and able suppliers to tender for contracts. To do this, the procurement organisation must have:

- Procedures which are fair, non-discriminatory, and transparent.
- Requirements which are clear -- using performance and international specifications where possible.
- Standard conditions of contract.
- Adherence to the Government's obligations under the contract, including the terms of payment.
- Good working relationships and trust with suppliers.

It is the responsibility of public buyers to uphold practices, policies, and procedures built around these concepts.

A cornerstone of a well-functioning public procurement system operating with integrity (fair, transparent, and credible) is the availability of mechanisms and capacity for independent control and audit of procurement operations to provide for accountability and compliance. Similarly, there must be a system for participants to lodge complaints and challenge decisions with administrative and judicial review bodies that also have the legal power to impose corrective measures and remedies against contracting entities in breach of the legal and regulatory framework. Fraud and corruption, including the issue of conflict of interest, should be addressed in legislation as well as through special measures in order to create a sound and fair environment for public procurement operations.

While the overall principles and objectives of good procurement are relatively well known, the extent to which the supporting legal framework knits these principles together to link individual procurement officers and their actions into a web of good governance is less understood. To help address this area and reduce "islands of integrity", we have developed a framework which allows us to highlight key elements in controlling corruption in public procurement.

Government buyers help control approximately 15% of the global gross domestic product. The sheer size of this effort and the tremendous impact public procurement has on so many aspects of the social and business cultures and mores within a country keep public procurement in the public eye. Procurement officials must be continually aware of the influence of their actions and the responsibility they shoulder to uphold the good of their country and its citizens. However, if the institutional underpinnings do not support honest and fair procurement actions, the virtuous civil servant can believe that he or she is a unique island of integrity in a sea of bureaucratic indifference to their personal and professional ethics.

An effective public procurement system will allow suppliers to provide satisfactory quality, service and price within a timely delivery schedule. The basic tenet of public procurement is straightforward: acquire the right item at the right time, and at the right price, to support government actions. Although the formula is simple – it involves questions of accountability, integrity and value with effects far beyond the actual buyer/seller transactions at its centre. A serious and sustained review of such decisions is needed to properly manage the public procurement function.

Transparency

Transparency, in the context of public procurement, refers to the ability of all interested participants to know and understand the actual means and processes by which contracts are awarded and managed. This requires the release, as a minimum, of information sufficient to allow the average participant to know how the system is intended to work, as well as how it is actually functioning. Transparency is a central characteristic of a sound and efficient public procurement system and is characterised by:

- Well-defined regulations and procedures open to public scrutiny.
- Clear, standardised tender documents.
- Bidding and tender documents containing complete information; and
- Equal opportunity in the bidding process.

Transparency requires that published rules are the basis for all procurement decisions and that these rules are applied objectively to all bidders. Transparency is an effective means to identify and correct improper, wasteful – and even corrupt – practices.

Corruption

Fighting corruption and improving financial accountability are essential for good governance. No country in the world appears to have escaped improper, wasteful and corrupt practices in public procurement.

Corruption deserves this special attention because it works in insidious ways. It tends to undermine the whole fabric of economic and political life. Thus, it is of extreme importance to establish and sustain correct behaviour in all procuring entities. Corruption, as defined by the World Bank[1] is the abuse of public office for private gain. This private gain could be in the form of money or favours for the benefit of family or friends – or for the benefit of special interest groups such as a political party seeking to obtain or retain power. Such behaviour by persons concerned with the procurement process often leads to economic losses for the public. Thus, many lose for the benefit of a few.

Public Interest

The "public" expects that its interests are protected, or at least considered by the government when deciding how national resources are to be spent. The ability of the business community to participate in the national procurement process helps assure its members that they can remain viable employers and productive economic units to build wealth and increase the tax base. Therefore, businesses feel a legitimate need to discuss or promote their interests as part of the overall "public" interest.

Transparency, or openness, of the decision-making process and actions of government are the most effective tool to directly or indirectly measure “the greatest good for the greatest number” in a Utilitarian sense. Transparency means that information is released in accordance with the rules, not indiscriminately to all people.

Information may not be available to the general public in matters classified for national security purposes or which are sensitive, such as in adjudicating the award of a competitive contract, for example. However, a transparent system will allow for some properly authorised representatives for public oversight (*e.g.* Public Accounts Committee of Parliament or Congress) to assure the public that government decisions followed proper procedures.

Islands of Integrity

In the context of a public procurement setting, where relatively large sums of money are dealt with daily, the pressure on an individual from within their society can be intense. Even where the procurement law or regulation clearly mandates proper behaviour, individuals in the procurement process may work within an organisational setting that at best is indifferent to how effectively these rules are practiced. Thus, where there is no sustaining system of support for correct actions, the dedicated procurement official becomes an island of integrity in an ocean of apathy. Firm leadership and clear communications can help link these islands with an effective institutional infrastructure.

1. *Helping Countries Combat Corruption*, Poverty Reduction and Economic Management Network, The World Bank, Washington, DC September 1997, page 8.

Building a Balanced Public Procurement System

Balancing competing interests is one of the main functions of a political system. Governments have struggled with how to allow competing interests to contend in the political arena within acceptable rules. Some countries have addressed the issues involving corruption in public procurement in a more complete manner than others. To help assess the issues involved and the means to control corruption, we have developed a framework (below) to use as a tool for review. This Framework highlights key elements in controlling corruption in public procurement. By focusing on how to define corruption and establish the means to expose it, corruption can be corrected.

Table 13.1. A framework for controlling corruption in public procurement

Functions	**Key elements**
DEFINE **by**	Criminal law, public procurement law, government regulations, professional code of ethics, custom and practice
EXPOSE **by**	Internal and external auditors, whistle blowers, public availability of government information, financial disclosure, protests of contract awards, other external oversight, professional diligence
CORRECT **by**	Implementation of law and regulation, protest resolution, management improvements
PREVENT **by**	1. PROFESSIONAL INDEPENDENCE: to assure the professional independence of officials in charge of procurement to make properly balanced decisions on the basis of merit and shield them from improper pressure of higher ranking politically designated officials 2. PROFESSIONAL STANDING AND TRAINING: to enhance the professional skills of the officials in charge of procurement and approaches used to train the officials in charge of procurement to prevent corruption and to enhance efficiency. 3. CHALLENGE and REVIEW SYSTEMS: Approaches used to resolve challenges to the rules promulgated and actions taken within the public procurement system 4. QUALITY CONTROL AND REVIEW SYSTEMS: Approaches to conduct pre and post award reviews and establish internal and external controls and process evaluation on the procurement process. 5. SYSTEM MANAGEMENT: Approaches to maintain the procurement infrastructure and keep permanent contact with operational officials.

Our ultimate goal is to prevent corruption within the public procurement system. To do so, we have set out for further review five topic areas. By considering these areas when looking at a procurement system's law and regulations, gaps in the system become more apparent for further attention.

1. *Professional independence:*

Strong institutional support at the top levels of government is needed for procurement personnel to promote integrity and the proper application of procurement law through independent administration and monitoring of the public procurement process. This leads to increased efficiency and professional performance in procurement operations. Strong rules to set out what is acceptable and what is not acceptable for procurement and other government officials can help safeguard this independence and control political influence and its distortions of economic efficiency and fairness. Knowing that strict rules are being enforced by the government can help dissuade any request for favouritism.

2. Professional standing and training:

Professionalism can be defined as the status, methods, or standards within a career area. Improving the professionalism of the procurement workforce is a means to link individual practitioners into a network to help control corruption. While being a professional does not eliminate the possibility of individual members being corrupt, it helps control improper behaviour by allowing actions to be judged against standards accepted by the profession.

Government officials performing contracting duties should be seen not as providing a clerical function but as part of the strategic process of controlling the use of government resources through a managed interaction with the private sector. Only by looking at officials in this way can a culture of professionalism and ethical behaviour be developed. Public procurement personnel need to clearly understand their role and develop the proper culture of responsibility and accountability to properly manage these resources.

3. Challenge and review systems

Complaints by disappointed bidders of government actions both before and after contract award allow the procurement process to improve. This is an important self-policing mechanism to assure good governance by allowing people most affected by the system to call attention to its shortcomings. Meritorious grievances of suppliers force a review of questionable or improper actions so that the procurement system is strengthened and integrity and accountability of government maintained.

4. Quality control and review systems

Internal and external checks of the procurement system, done in a reasonable manner, can pay dividends of more uniform policy approaches, improved cost controls and fewer instances of corruption or waste. Procurement personnel are involved in every aspect of the contracting process to some extent, but they rely on others within the organisation to fulfil major functional responsibilities in many aspects of the process. In addition to those with direct involvement, indirect roles typically are given to others in the public organisation for purposes of providing a system of checks and balances. These include approval authorities and auditors.

5. System management

Government procurement objectives will not be achieved simply by developing procurement rules. Like in the sport of football, the rules provide the guidelines under which the game is played but compliance with the rules alone does not make a competent or successful team. It requires constant attention to the state of play and devising up-to-the-minute strategies to reach your goal. To do this in public procurement, an organiser or supervisory body is needed to ensure that all the procurement entities are working

The Framework matrix can be an effective tool for review when it has been tested and perfected against more examples of national procurement systems. By perfecting and applying this matrix to OECD member countries, we expect to begin a dialog of just what are the critical elements in controlling corruption in public procurement and in what manner have these elements been addressed by various countries. It is expected that differences in approach will be featured through comparison of the completed Frameworks. These differences may be due to varying and unique national requirements or they may indicate areas for development of national policies which can lead to an overall strengthening of the compared systems. In the final analysis, further review of the public procurement legal framework can lead to a better understanding of policies and procedures that support procurement professionals so they are effectively linked and supported in this important public management task.

Chapter 14

Ensuring Accountability in Public Procurement:

Bridging Information Asymmetry

by

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This is an abstract from a paper on "Transparency and accountability as tools for promoting integrity and preventing corruption: possibilities and limitations". It seeks to identify the way in which opportunities for corruption arise in the context of procurement. In looking at the government as a buyer, it considers the position of the procurement officer acting as agent on behalf of the elected government. The paper investigates the divergence between the agent's personal interest and that of the government and of the public and narrows down the opportunity for such deviations to the existence of informational asymmetries.

The procurement function is not a cause of corruption; it merely provides an opportunity which the potentially corrupt may seize upon to engage in corrupt practices. Procurement regulation is able to close off a number of those opportunities but it cannot address the wider causes or prevalence of corruption. There is a built in limitation to what it can achieve. Once those opportunities have been reduced or eliminated, further or stricter regulation does not lead to the commensurately increased elimination of corruption; it merely adds a further layer of bureaucracy and/or control which unnecessarily hinders the efficiency of the procurement function. Given the skill needed to carry out efficient and economic procurement, purchasers need the flexibility to exercise their professional judgement. There is nothing inherently wrong with such discretion; it is only the misuse of that discretion which must be avoided. Eliminating professionalism from the procurement function reduces procurement to a mechanical function which deprives the public purchaser of the ability to measure value for money. A balance needs to be struck between the desire to impose regulations aimed at reducing corruption and the benefit to be gained from promoting professional and ethical procurement.

The procurement agent is able to exploit his position and the discretion given to him because he possesses greater information than his government principal on the products to be procured, the tenderers offering to supply and the markets themselves. His ability to use or to conceal information enables him to act for his own benefit. To realign the interests of the agent with those of the principal, the government needs a method of administrative control, generally in the form of procurement regulation, which provides incentives for compliance. The trick of procurement regulation is to impose the right incentive or disincentive at the right time. By controlling the process of procurement, through decentralised procurement regulation, rather than the outcome, through direct supervision, the regulator is able to improve the system of procurement and allow those directly interested in the outcome, the tenderers, to act as watchdogs of that system. Most modern procurement systems employ similar devices based on the twin pillars of transparency and accountability. The importance of transparency is that it makes visible what would otherwise be concealed and allows the actions of the agent to be verified objectively. Where actions and decisions can be verified, the opportunity for corruption, assuming that effective enforcement procedures exist, is significantly reduced. The transparency tool is applied in a number of ways: the choice of procedure; the publicity requirements for tender and award notices; the use of technical specifications; the application of qualification and award criteria. By setting out the broad parameters of the choices to be made by the agent and by requiring the agent to make public the specific choices made and the decisions based on them, the regulator enables the interested parties to monitor and verify compliance with the public policy objectives of procurement regulation.

Where, in a modern procurement system, the agent is given responsibility for his actions, he must also be made accountable for them. The transparency provisions of the

regulation will ensure that his actions may be verified but it is also necessary to put in place systems and fora within which such verifications may take place. Recording and reporting mechanisms are in the front line of this exercise and these are complemented by internal and external audit systems. In specific cases where action needs to be taken at short notice, efficient and effective enforcement mechanisms to be initiated at the suit of disappointed tenderers are also critical. Given the time and cost involved to make it effective, direct supervision is a redundant mechanism in any country system. Such supervision may be beneficial in more limited circumstances but is unworkable when faced with the number, breadth and scope of contracts let throughout a country. Enforcement of the regulations by tenderers will only be effective, however, where the system in place is credible and where it provides tenderers with the confidence that the regulations are enforced objectively and independently of any government influence. Regulations which are not effectively enforced will not be applied and the savings to the public purse which may be expected to flow from the proper application of the regulations will be lost. The same would be true where, notwithstanding apparently effective enforcement, the results are undermined by politically motivated immunities and amnesties in respect of convictions for corruption which benefits political parties.

Informational asymmetries affect not only the principal but also the agent. The agent also needs to gather relevant information which is possessed by the market and the tenderers. He needs to do this is order to make an informed procurement decision based on available technologies and guided by market prices. The transparency tools of the procurement regulation must also assist, and not merely control, the agent in this regard. A 'theological' approach to procurement regulation, ostensibly pursued to combat corruption, may well lead to the inability of the public purchaser to exercise professional judgement and confine him within a redundant bureaucracy. The conditioned reflex of most regulators against any form of discussion between purchaser and tenderers will often also condemn the government to the purchase of outdated technologies at inflated prices.

To avoid losing the benefits to be expected from effective procurement regulation, a balance needs to be struck between combating corruption and promoting professionalism in procurement. Equally important are the commitment of the government and the efforts made to develop capacity to provide proactive and ethical procurement officers capable of achieving the financial and economic benefits to be gained from transparent, efficient and competitive procurement.

Chapter 15

A Comparative Analysis of Public Procurement Practices: A French Perspective

by

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Introduction

The objective of the Task Force Report in 2001 was to examine public procurement practices in the majority of OECD countries and provide recommendations for improving the French procurement system.

Practices in OECD countries seek to strike a balance between two major constraints:

- Economic efficiency, *i.e.* achieving value for money.
- Legality, *i.e.* ensuring competition and transparency in the choice of suppliers.

Introducing good practices in public procurement in ways that meet these two constraints will result in a considerable reduction in the cost of government procurement. The range of savings identified in the studies consulted by the task force is from 5% to 30%, depending on the country and the type of purchases. The financial stakes involved in sound procurement practices are therefore considerable. In 2000 that figure amounted to some 114 billion euros in the case of France**.**

Implementing these good practices requires a commitment at the highest level of government. The United States example is typical. In that country, during President Clinton's two terms in office, great priority was given to a programme called Reinvesting Government, and public procurement reforms were an essential component of that programme.

This chapter establishes two points:

- Achieving a significant reduction in the cost of government procurement, while maintaining quality at the same or higher levels, requires implementing the series of "good practices" described below, while respecting the legality constraint.
- France finds itself handicapped, to an even greater extent than some other countries, by the unbalanced weighting now given to these two constraints, whereby the legality factor takes priority. Correcting this imbalance will require the introduction, initially on an experimental basis, of a central office responsible for piloting the systematic introduction of sound procurement practices.

Good practices identified abroad

These have involved reforms addressing the following eight points:

1. A comprehensive concept of public procurement that goes beyond procedures for choosing suppliers. The upstream phase (defining needs) and the downstream phase (managing contracts) are equally important.
2. "Switching on" the government apparatus by giving departments and agencies responsibility for procurement management, through the globalisation of budgetary appropriations (including those for personnel) and setting quantitative and qualitative targets.
3. Centralising functions relating to:
   - Defining broad organisational principles for the procurement function, preparing rules and procedures and disseminating good practices.

- Centralised negotiation of umbrella agreements between the government and its principal suppliers ("framework contracts") so as to benefit from economies of scale without undermining budgetary decentralisation. These two constraints can be reconciled by a provision to the effect that framework contracts do not have to be used when procurement officers can demonstrate that they have found more effective solutions.

4. Raising levels of professionalism and accountability among public procurement officers. The quality of purchasing depends on that of the procurement officer. There should be a specific procurement officer function in government, as there is in public and private enterprises. Making buyers accountable means that their initial and on-the-job training must be adequate, their objectives must be clearly defined, they must have real autonomy in conducting their purchases, and they must be subject to ex post control, backed by meaningful sanctions in case of non compliance.

5. Using new technologies such as the Internet. This concerns in particular:

   - The competition phase, which includes publishing calls for tender, receiving bids from potential suppliers, and providing information on contract awards.
   - The relationship with suppliers: access to their catalogues, direct placement of orders, online invoicing and payment.
   - Simplifying payment procedures by making more use of acquisition cards which, in the United States, have cut procurement management costs by more than half. From the suppliers' viewpoint, cutting payment times from 60 days to three days is a significant benefit.

   The Boston Consulting Group estimates that intelligent use of these new technologies can cut overall procurement costs by 15% on average.

6. An approach to setting regulations that takes account of the entire procurement process. The objective is to produce practical guidelines that will allow procurement officers to observe both formal regularity and economic efficiency. These guidelines are revised at regular and fairly short intervals on the basis of proposals from bodies representing all parties concerned. Those proposals are subject to critical and constructive examination by all practitioners concerned before they are adopted.

7. Introduce two specific procedures

   - The first relates to the framework contracts mentioned above, which allow a procurement officer to deal with pre-selected suppliers and, when necessary, to open purchases to competition.
   - The second procedure, negotiation, is an essential tool for obtaining the best conditions from a supplier when undertaking more complex or more innovative projects. In the United States, for example, all procurement contracts exceeding USD 100 000 are awarded through a process that combines bidding and negotiation.

   The necessary counterpart to the flexibility that these procedures offer is that purchasing officers are held accountable for the nature of the negotiations conducted, the objectives pursued and the results obtained, and must justify them before the supervisory bodies, which will watch out for any compromise of principles in dealings with suppliers. The key word here is "traceability". If an inspection reveals any deviation, the situation is addressed immediately and disciplinary sanctions are imposed.

8. Redirecting supervision

Four points need to be underlined.

a) Reform of procurement procedures and the attendant regulations, as they relate to *ex post* control, should result in an evaluation of the efficiency and the legality of a purchase. That evaluation requires a multi-criteria analysis that must be built into control procedures. This presupposes a thorough overhaul of control techniques.

b) A powerful factor for maintaining transparency and ensuring that purchasers pay due regard to the constraint of impartiality results from the fact that any decision to discard a bid must be justified in detail, and the justification must be sent to the candidate concerned. In the United States, a bidder has the right to ask for a debriefing session that analyses the reasons why his bid was rejected.

c) When the procurement team embraces of varied range of membership, it is better placed to take into account all the concerns of efficiency and regularity. Those teams should include legal experts to back up the technical, accounting, financial and commercial expertise of other participants in the procurement transaction.

d) *Ex ante* controls have now been virtually replaced by *ex post* controls conducted both within and outside the procurement structure.

To put things into perspective, it may be said of the countries that have effectively implemented this set of "good practices" that they:

- Have achieved very substantial savings in the purchase of goods and services, at the same or higher levels of quality.
- Have encountered no major problems with corruption in public procurement, as far as the task force can judge from media reports and from the contacts interviewed.

The situation in France: findings and proposals

Findings

France suffers from an imbalance between the relative weighting of the two constraints facing public procurement officers. The "legality" constraint has to some extent pushed aside the "economic efficiency" constraint. This situation reflects the fact that legal irregularities in implementation of the public procurement code's provisions relating to equal access to public tendering are subject to criminal penalties. The legislation governing those penalties dates from 1991 and 1995. While the number of convictions to date has been low, the high profile of some of the organisations implicated has led French government procurement officers to concern themselves primarily with legality issues. To this must be added the fact that there is no penalty for failure to optimise economic efficiency.

Proposals

The effective and generalised introduction of "good practices" is a long-term undertaking, as the task force found in studying a sample of countries. The task force has however identified a measure for starting the process: introduction on an experimental

basis of a central office responsible for overseeing the systematic introduction of good practices in public procurement.

That structure will initially operate solely within the Ministry of Economy, Finance and Industry (MINEFI), where it would report to the Secretary-General and the DPMA. (Direction of Personnel, Modernisation and Administration). A provision will have to be added to the public procurement code in order to proceed with this experiment. The office will conduct an audit of procurement contracts, looking at how they are organised and at the products and services purchased, and would then establish some targets for cost savings. Its task will be to group purchases where this is found to be useful, to propose regulatory amendments, and to upgrade the indispensable system of procurement statistics. In time, it could take on an interministerial function, such as that of the United States' Office of Federal Procurement Policy.

The success of such an initiative will depend on who heads up the office, and on that person's position within the hierarchy. The director will have to be of sufficiently high rank and must have a solid track record at the head of a notably successful procurement office in a public or private corporation. The person will need to be recruited through a transparent procedure.

Apart from the "core" responsibilities described above, the pilot structure would be involved in the following six areas:

1. Promotion of good practices among procurement officers, with particular attention to**:**
   - Organisation of the procurement process in its different phases, which must involve all the necessary fields of competence (legal, technical, accounting and financial, commercial).
   - Co-ordinating the network of procurement officers and making them more accountable, on the basis of sound ethical rules and an evaluation of outcomes.
   - Organising and monitoring initial and on-the-job training for procurement officers.
2. Introduction of internal procurement audits.
3. Proposals for regulatory amendments, developed with input from all practitioners.
4. Provisional introduction (without awaiting amendments to the current legal framework) of truly effective procedures relating to negotiated contracts and framework contracts for grouping purchases that lend themselves to this approach. This experiment would be based on an external advisory and supervisory mechanism in which the current control bodies would participate: the Specialised Commission on Markets (Commission Spécialisée des Marchés [CSM]) the expenditure commitments supervision office, and the interministerial task force investigating public procurement.
5. A shift to ex-post control.
6. Use of electronic procurement procedures: this would involve, first of all, creating an electronic catalogue, experimenting with electronic procedures for selecting suppliers, and paying by means of acquisition cards.

Conclusion

The financial stakes in the systematic introduction of good practices in public procurement are high. Yet it must be admitted that French administrative culture does not readily lend itself to practices that will accord equal degrees of legitimacy to economic efficiency and legal regularity: our culture tends to place legality ahead of efficiency. Systematic introduction in government agencies and departments of the good practices identified by the task force will require strong political will, and the programme will have to be constantly monitored at a sufficiently senior level.

Chapter 16

Latin America:

Conditions for Effective Public Procurement Regulations

by

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Introduction

This paper presents some of the results of a study conducted by the author on the public procurement regulations of Latin American countries. The study includes 18 countries, but this report limits itself to eight of them. The methodology applied begins from a particular standpoint: the main significance of a public procurement regulation lies in the fact that it establishes the manner in which economic exchanges take place in the public market. What is regulated is the economic order, and that fact justifies studying regulations from the perspective of their allocative efficiency. One of the causes of economic inefficiency is corruption.[1]

As a crucial interface between the public and private sectors, public procurement (PP) is particularly vulnerable to distortions aimed at favouring particular suppliers. Public officials use the rules to restrict the participation of interested firms and direct the outcome to someone. In virtually all cases such interventions happen in return for a bribe. Much turns round the discretionary powers of the public agent. The more they are able to establish the conditions affecting the PP, the more opportunities there are for them to use such powers to manipulate information and bias the procedure. Their ability to decide comes directly from the regulations.

By-products of bribery in procurement are overpricing, substandard goods and services, unfinished projects, unnecessary works and many other waste-generating effects. Competition among firms is replaced by a stratified system of cartelised groups arranged by size and specialties. Partitioning of markets and price-fixing are stimulated. Firms become prisoners of a pecking order and are forced to play a game in which big players hold the trumps. Sectors subjected to such market distortions cannot evolve healthfully. Innovation and personnel training are stifled, because cost-saving efforts cannot compete with the unfair advantages given to others. Concentration limits the creation of jobs. Therefore, corruption in procurement harms competition.[2] The converse is usually also held[3] – that one remedy against corruption is to enhance competition.

Environments prone to bribery have a high probability of becoming totally compromised. In Weber Abramo (2003a) it is shown that if one single participant has a certain propensity to bribe in order to win contracts, then for the other participants it becomes irrational not to bribe. As participants tend to try to get the upper hand over others, the equilibrium is unstable and the propensity of tenders to become affected by bribery tends to 100% over time. It is also shown that prevention is more effective than detection/punishment to achieve better efficiency and less corruption, and that the regulations must evolve continuously because participants in the market are not passive bystanders, but actively seek ways round the legal strictures in order to win contracts.

Actually measuring in monetary terms the economic efficiency of a whole country's public procurement environment would entail collecting a representative sample of (unit) prices for a representative set of goods and services purchased by a representative set of state institutions and comparing them with those of other countries', suitable segments of the private sector or both, all this compensating for an array of local variables possibly affecting the prices. Although not impossible in principle, such a de facto assessment would not be feasible in practice.

Instead, we try to assess the presumable (*de jure*) inefficiency of a country's regulation stemming from the rules governing its public market. The presumable inefficiency is mainly (although not exclusively) identified with the inefficiency of the flow of information from the state to participants (and the public in general) and vice

versa in tenders, as imposed by the regulations. To do this, a set of qualitative conditions was defined and each country's regulatory framework parsed to assess its compliance with the requirements defined by the conditions.

Good public procurement regulations are a necessary condition for achieving efficiency in the public market. Environments in which PP regulations are lax and vulnerable cannot possibly lead to overall efficiency and honesty. Tenders will probably be biased, because the opportunity is there to be taken. As the propensity for efficiency in a PP set of regulations is here identified to the degree it enhances competition, this puts a heavy burden on the market itself. Participants must be up to the task of using the power of the regulation to guarantee their rights and defend themselves against opportunistic attacks.

However, a good PP regulation is not a sufficient condition for efficiency – because the laws might simply not be enforced, or the judiciary might not function very well, or for numerous other reasons. Foremost among these are market failures – that is, situations in which the participants do not act according to economic rationality. This happens for instance in cartelised markets, in markets dominated by oligopolistic interests, etc. Thus in such cases, even when the regulations are healthy, broader economic inefficiencies hamper the efficiency of the public markets. This is an important dimension of the environment in many developing countries.

A central contention of this note is that achieving the healthiest PP regulation possible should be the first and foremost priority of those who strive for better economic conditions in public markets.[4] In this case the goal is an urgent one, as the panorama stemming from the study is bleak. In almost all cases, one is forced to conclude that it is unlikely that public procurement conducted in the countries in question can be efficient and/or honest.

No attempt was made to use the findings of the study to place countries in a ranking. Although doing so would be straightforward (modulo decisions as to weights attributed to conditions), it would cast the study into an unintended frame of competition among countries. Although for some there is a commercial-driven interest in comparing countries' environments, for those who live in those countries what matters is how much the state is able to avoid waste not only in international tenders, but also (and principally) in its day-to-day purchases. In any country, far more resources go into the run-of-the mill operation of the state than into big projects.

This paper looks at the process after the decision to launch a project was taken; it does not address the conditions whereby such decisions are reached. Execution is not addressed. Regulations for concessions and public-private partnerships were not included in the study. Some countries have special laws for public works; these are taken into account here.

Risk conditions

Acts of corruption can generally be divided into two categories: those that originate in unlawful acts, and those that come from lawful manipulation of regulations. The first are the easiest to detect, given that controls exist. For instance, if a public official falsely attests that a contract is being executed according to specifications, then in order to identify wrongdoing it suffices to compare those specifications with the contract. Fundamentally, evidence as to the wrongdoing exists. Once a public official and a firm break the law, the fact that money changed hands is only a detail and bribery may be presumed, even if perhaps not actually proved and even less punished. Directly proving that bribery occurred is always very difficult, due to the secret nature of the act. Corrupt

people do not issue receipts and bribers avoid registering this type of financial dealings in their books. Tracing money across bank accounts, phantom firms, go-betweens and fiscal havens is not an easy accomplishment, and the expenses involved preclude applying sophisticated investigation techniques on a day-to-day basis. This means that despite the critical role played by the efficiency of control and enforcement mechanisms in shaping the expectations of participants, one should not stake exaggerated hopes on it.

Cases of corruption of the second, "lawful" kind tend to be much less detected than cases of the first, "unlawful" kind. What is "lawful" corruption? For instance, suppose an environment where requirements for the qualification of firms to bid in tenders – such as thresholds for capital and/or liabilities, "technical experience" and so on – is freely defined by the agent. It then becomes very easy to lawfully use such requirements to erect entry barriers[5] to favour one participant at the expense of the others. As the restrictive conditions are perfectly legal, in order to prove that a tender was deliberately biased it becomes necessary to prove that a kickback was paid – and this is very difficult. In contrast, in an environment where conditions are not subjected to public officials' whims, directing tenders is more difficult. A perfect system would completely eliminate opportunities for public officials to erect entry barriers, and thus would restrict corruption to unlawful acts. Therefore, while punishments and controls are the factors exerting the strongest effect on the financial expectation of both firms and public officials involved in tenders,[6] their continuous application is expensive and improbable. Acting on the institutional environment produces a more profound effect on the system's efficiency – one that goes far beyond tackling simple corruption – making controls less critical. Furthermore, the institutional framework must evolve continuously over time in order to catch up with the evolving techniques the actors develop to maximise their expectations.

In many environments regulations are very lax and vague, mentioning only that tenders must be "fair", that "equal opportunity" must be guaranteed, and so forth. For instance, this is how the guidelines for procurement issued by international financing institutions are framed. However, those terms are virtually devoid of actual meaning. "Fairness" in things concerning the public interest is not something that can be left to the decision of one person, or of a group, however well-meaning they may be – "fair" should be what the law says is fair, doubtful cases being resolved when necessary by the judiciary. However, regulations for the majority of countries examined here exhibit vagueness rather than exactness. It is not uncommon that a legal provision uses certain catchwords (such as "transparency", "efficiency", "advantageous conditions", etc.) but then does not guarantee such things. Many laws state that the public agent "might" do this or that.

As corruption stems from the discretionary power of public agents, it follows that diminishing the latter favourably affects the former. This points to laws that are, to the extent possible, procedural. "Fairness" and other desiderata for public markets should be explicitly defined in each case so as to stimulate competition and avoid individuals benefiting from entry-barrier-erecting prerogatives. Finally, a requirement of openness for public markets requires that information held by the principal must be equally shared with interested parties (and the public).[7]

Literally all public procurement procedures constitute potential entry points for the exercise of harmful discretionary power by inefficient practices and/or public agents. In public procurement as nowhere else, the devil is in the detail. The study does not try to be exhaustive as to competitive criteria, but limits itself to around 20 conditions. Of these, 12 are cited here, along with brief justifications for choosing them:

1. Guaranteeing that regulations are uniform across all public organisms.[8]

   Different rules for different offices correspond to passive economic entry barriers and stimulate cartels. The need to hold operational knowledge about different sets of regulations elevates the transaction costs and, a fortiori, the final price.

2. Requiring that all information pertaining to a) a tender and b) the ensuing contract is made public.

   Otherwise, privileged information can be used to direct the tender to "preferred" participants.

3. Not allowing for the terms of the contract to be altered by negotiations between the winner and the agent after adjudication.

   This leads to contracting something different from what was tendered.

4. Requiring that the announcement of the tender maximally specifies the object to be purchased, in order to avoid arbitrary decisions later that adjudicate that contracts be given to firms with characteristics not previously specified.

   As the procurement process must not depart from the equal information principle, such uninvited peculiarities should not be considered in the decision.

5. Requiring that formal conditions for participation (that is, requirements not involving the tender's nature but only the firm's status) do not depart from reasonable factors and explicitly stated percentages. These requirements must be limited to firms' capital and liabilities, their compliance with national laws concerning taxes and labour obligations, and their not being blacklisted because of previous offences.

   There is no economic justification for imposing non-capitalistic conditions for firms to participate.

6. Likewise as to contractual guarantees and penalties.

   Arbitrarily defining guarantees payable due to total or partial non-compliance elevates costs, lowers welfare and can be used as an entry barrier.

7. Guaranteeing that the decision process is always explicitly stated in the announcement and is based exclusively on objectively measurable factors. In particular for standard goods and services, public works and systems using commodities as components (such as computer systems, telephony, etc.), prohibiting the attribution of "grades" to items in a proposal, which is unavoidably subjective.

   While it is impossible to avoid a degree of subjectivity in certain tenders (as in the case of consultancy, new technological solutions, or contests for projects), it is not true that subjectivity inherently intervenes in all types of tenders. In those cases, the decision should be attributed to bodies formed not only by public officials, but also by members of the public and/or the professions.

8. Providing for open mechanisms allowing the public to follow all procurement processes.

   Not only participants but also community organisations, special interest groups, NGOs and so on can monitor tenders in the presence of pertinent information.

9. Penalising non-performance of contracts.

   If no penalty exists, or if the penalties are feeble, then opportunists will maximise profits by executing only the easiest aspects of a contract.

10. Guaranteeing participants and the public the right to administratively contest agents' decisions.

    The absence of the right to contest administrative decisions confers immense discretionary powers to public agents.

11. Guaranteeing participants and the public the right to judicially contest agents' decisions.

    The right to judicial contest is one of the most fundamental rights in the market. It allows participants to fight the refusal of public agents to appropriately consider administrative challenges.

12. Explicitly criminalising corrupt behaviour of both public administrators and corruptor firms' representatives.

    If bribery of firms against the state in PP is not made a crime, the only recourse for the state is commercial law, which usually omits criminal offences.

Countries and sources

The countries whose regulations are partially reported here are listed in the following table, together with a set of demographic and economic indicators.

Table 16.1. Demographic and economic indicators of participating countries

	Population	***GDP***	***Imports***		***External debt***
			Goods (FOB)	***Services***	
Argentina	38 401	102 042	8 470	4 540	134 147
Brazil	177 268	452 410	47 219	14 644	227 689
Chile	15 774	66 425	15 827	4 917	40 395
Colombia	44 562	80 924	12 077	3 315	37 336
Ecuador	13 343	24 311	6 196	1 546	16 236
Mexico	103 301	637 036	168 679	16 740	138 736
Peru	27 148	56 430	7 440	2 493	27 872
Venezuela	25 554	94 021	13 622	3 852	32 290
Totals	***444 .351***	***1 513 599***	***279 530***	***52 057***	***654 701***
		Current prices, 2002			2002
	millions	USD 1,000 millions			

Source: Economic Commission for Latin America and the Caribbean, *Statistical Yearbook for Latin America and the Caribbean 2003*

The countries' regulations were collected from various sources, mainly the Internet. A hierarchy of preferences was applied to collect the regulations, ranging from Legislative databases from each country to databases maintained by the executive, to secondary sources including multilateral organisms, research institutions, law firms and others. Secondary sources were used only after attempts to obtain the laws from consular or diplomatic representations in Brazil failed. One of the reasons why no Caribbean country is included in this study was that it was impossible to find their laws[9]

Application to countries

In what follows, the regulations for the eight countries are assessed for the 12 conditions. Each condition is taken in turn for all countries and an assessment is provided. A "Yes" means that the risk is avoided in the regulation in question and a "No" otherwise. It may be that the condition is only partially met and sometimes the regulations are unclear; this is noted, although in practice obscurity more often than not means "No". The "Observations" column is used to clarify the assessment and/or to exhibit specific codicils. Laws and decrees are identified by letter-number combinations (L1, D2), country by country. Throughout, "Federal" means the national sphere.

Table 16.2. Conditions for limiting harmful discretionary power

	Condition 1: Regulations are uniform across all public organisms.	**Condition 2:** All relevant information pertaining to a) a tender and b) the ensuing contract are made public.	**Condition 3:** The terms of the contract cannot be altered by negotiations between the winner and the agent after adjudication.	**Condition 4:** The announcement of the tender specifies in detail the object to be purchased.	**Condition 5:** Formal conditions for participation do not depart from reasonable factors and explicitly stated percentages.	**Condition 6:** Requiring that guarantees the winner must provide do not depart from reasonable factors and explicitly stated percentages.
Argentina	No	a) Yes b) No	No	Yes	Unclear	Yes
Brazil	Yes	a) Yes b) Yes	Yes	Yes	Yes	Yes
Chile	No	a) Yes b) No	No	No	No	No
Colombia	Yes	a) Yes b) Unclear	No	No	No	No
Ecuador	Partly	a) Partially b) No	Yes	Yes	No	No
Mexico	Yes	Yes	Yes	Yes	No	No
Peru	Yes	Yes	No	Yes	No	No
Venezuela	No	Unclear	Mainly	Yes	No	No

Table 16.3. Conditions for limiting harmful discretionary power (cont'd)

	Condition 7: Guaranteeing that the decision process is a) always explicitly stated in the announcement and b) is based exclusively on objectively measurable factors.	**Condition 8:** Providing for open mechanisms allowing the public to follow all procurement processes.	**Condition 9:** Penalising non-performance of contracts.	**Condition 10:** Guaranteeing a) participants and b) the public the right to administratively contest agents' decisions.	**Condition 11**: Guaranteeing a) participants and b) the public the right to judicially contest agents' decisions.	**Condition 12:** Explicitly criminalising corrupt behaviour of both public administrators and corruptor firms' representatives.
Argentina	a) Yes b) No	Yes	Yes	a) Yes b) No	a) Unclear b) Unclear	No
Brazil	a) Yes b) Yes	Yes	Yes	a) Yes b) Yes	a) Yes b) Yes	Yes
Chile	a) Yes b) No	Yes	It seems that Yes	a) Yes b) No	a) Unclear b) No	No
Colombia	a) Yes b) No	Yes	Yes	a) Partially b) Partially	a) Unclear b) Unclear	No
Ecuador	No	No	Yes	a) Partially b) No	a) Unclear b) Unclear	No
Mexico	a) Yes b) Partially	No	Yes	a) Yes b) No	a) Yes b) No	No
Peru	a) Yes b) No	No	Yes	a) Yes b) No	a) Unclear b) Unclear	No
Venezuela	a) Yes b) No	Partially	No	a) Unclear b) Unclear	a) Unclear b) Unclear	No

Notes

1 A first version of the study reported here was co-ordinated in early 2002 by the author, within a project sponsored by Transparency International aimed at evaluating the vulnerabilities affecting public procurement in a number of Latin American countries. The methodology was based on the definition of 22 opportunities for interference by the public agent and the identification of their presence in each environment. The procedure was affected by lack of methodological uniformity and by the fact that in-country assessments were not subjected to independent certification..

2 See *e.g.* Mauro (1995 and 1998), Tanzi and Davoodi (1998), Søreide (2002).

3 By Rose-Ackerman (1996, 1999) and others.

4 For a critical examination of one particular type of non-institutional approach, see (Weber Abramo, 2003b).

5 "Entry barrier" is used throughout to refer to extra-market obstacles created by public officials to avoid or make difficult the participation of interested firms to the benefit of other, "preferred", firms at any point in the tender process. Entry barriers are not limited to the announcement of a tender, but may be erected anytime along the way.

6 Cf. (Weber Abramo, 2003a).

7 Compte and Jehiel (2002) find that more competition leads to better welfare in symmetric auctions (all bidders share the same information), but the opposite happens in asymmetric auctions. The introduction of one additional participant holding information the others do not share lowers the welfare.

8 Reasoning on the basis of a model and applying it to the European Union, Ganuza and Hauk (2001) argue that different propensities to corruption hamper economic integration between countries (the adoption of common rules) and, conversely, that the forces acting on integration can help reduce corruption in member countries.

9 The lack of straightforward availability of the appropriate legislation, verified in many countries, in itself constitutes a bad sign.

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Chapter 17

China:

Legislating Anti-Corruption Measures in Government Procurement

by

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The evolution of government procurement and the challenge to anti-corruption efforts

Government procurement is a very important mechanism for the Chinese government, because it is used to manage total demand and maintain the sustainable growth of China's economy. Since the Asian economic crisis in 1997, the government has been expanding its financial investment in order to stimulate the economy and in so doing create more economic demand. China has now been implementing an expansionary policy in public finance for seven years. Long-term national construction bonds issued by the Ministry of Finance have been accumulating and now total CNY 900 billion (the equivalent of 89 billion euros). Moreover, the financial revenue of China has been increasing steadily. Last year's government procurement market has thus reached an estimated CNY 1 000 billion (the equivalent of 99 billion euros).

The current trend of expanding government investment and procurement led to corruption, which damaged the government's image. Most affected by this problem are transportation administrations in local governments: because of bribery, directors in several provinces have been dismissed from their position and are under investigation. Generally, the transportation administration is in charge of road investment and construction projects; it is authorised to make decisions on inter-provincial road projects as well as projects in counties and towns. However, public bidding procedures leading to procurement contracts are not observed in granting. This makes bribery possible.

From 2005 China is going to adopt a neutral financial policy, which means a moderate lowering of the deficit, adjusting the structure of public investment, and abolishing or cutting some agricultural taxes. However, China will continue to place the emphasis on using financial policies to adjust the market. One reason is that the monetary market in China is not yet mature, so there is little room for adjusting the market through monetary policies. Another is that government revenue from tax is increasing rapidly. A large portion of the money is going to be invested in government projects, *e.g.* infrastructure (*e.g.* road construction), public service (*e.g.* education), and projects to build the government information network (*e.g.* e-governance). In the future China will continue to face severe challenges in its fight against corruption in government procurement arena.

Regulations on anti-corruption in the Government Procurement Law

In 1996, China embarked on pilot government procurement programmes in several major cities. This was the first time the country attempted to apply modern government procurement methods. In 1999, the top legislative body officially launched the drafting of what was to become the Government Procurement Law of the People's Republic of China, which took effect in January 2003. In drafting this law, China to a large degree adopted the UN Commission on International Trade Law (UNCITRAL)'s Model Law On Procurement of Goods, Construction and Services. The following provisions of that law relate to anti-corruption.

Lawmaking

Article 1 specifies that one of the purposes of this law is to "promote honest and clean governance." As a rule the contents of the first article of a law are deemed very important in China; since they specify the main purposes and mission of the lawmakers, article 1 provide a frame of reference for the articles that follow.

Supervision authority

Article 7 of this law is about examination and supervision. It specifies that both the auditing and supervisory authorities shall exercise their powers over government procurement. The Ministry of Finance acts as the main supervisory authority.

Legal liabilities

When the procuring entity or the procuring intermediary or their staff accept bribes or acquire other improper interests and benefits, they shall be prosecuted if their actions constitute a crime. If the actions constitute a misdemeanour, a fine shall be imposed. Any illegal benefits shall be jointly confiscated. If the wrongdoers are civil servants, they shall be subject to administrative discipline.

When a supplier bribes or provides illegal interests and benefits to the procuring entity or intermediary, a fine ranging from 0.5% to 1% of the total procurement value shall be imposed, and the offending suppliers shall be blacklisted and disqualified from subsequent procurements for 1-3 years. When illegal benefits arise, these shall be confiscated. When the offence is materially serious, their business licences shall be revoked. If their activities constitute a crime they shall be prosecuted, and the final result of the tender shall be invalidated.

Government procurement procedure

As for procedures, the relevant provisions first set up some general principles that all should abide by. These include the principles of transparency, fair competition, justice and honesty. Second, the provisions establish the principle of withdrawal: when a conflict of interest occurs between the personnel carrying out specific government procurement and the suppliers concerned, the former shall voluntarily withdraw from the procurement proceeding. Third, they regulate the relationship between the procuring intermediaries and the government agencies. It is specified that the procuring intermediaries shall not have any subordinate relationship or other relationship of interest with the government procuring regulatory authority. At the same time, they are not allowed to obtain illegal benefits through bribery or other inappropriate means. Fourth, methods of procurement and their respective procedures are specified. It is established that public tendering is the main method (of five) to be adopted; the others are exceptions.

Fresh progress in the legislation of government procurement in China

In China, laws are usually general; administrative agencies will make regulations that provide further details as a supplement. China's Ministry of Finance promulgated three important administrative regulations for government procurement in 2004. The three came into force on 11 September 2004: the "Regulation on Bidding of Goods and Services in Government Procurement", "Regulation on Information Disclosure in Government Procurement" and "Regulation on Handling Suppliers' Complaints in Government Procurement". According to the Government Procurement Law of China, the State Council (the top administrative agency) is now formulating an implementation regulation for the law.

China's accession to Government Procurement Agreement (GPA) of the WTO is gaining a great deal of attention from all quarters. At the time of its accession to the WTO in 2001, China declared its intention to become a member of the GPA, and promised to begin negotiation as soon as possible. With the backing of a government authority, Tsinghua University has been engaged on a research project focused on this negotiation.

Chapter 18

Hungary:

Establishing Control Mechanisms in Contract Award Procedures

by

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Introduction

In 1995, the Hungarian Parliament passed the first "modern" law regulating public procurement (Act XL of 1995 on Public Procurement). The law has several well-known objectives: to establish an effective and transparent system in awarding public contracts, to rationalise public expenditures, to provide fair competition, to create a basis for a gradual legal alignment to the European "acquis", etc. At the same time, the new system requires institutional solutions for auditing and monitoring public procurement activities in Hungary.

When in 1995 the legislators created the public procurement law, they established a specific structure in order to implement the objectives incorporated in the law. The mainstay in this structure was the Public Procurement Council, an independent body directly reporting to Parliament. Apart from the Council many other organisations were given new duties with regard to controlling specific areas of public tenders: the State Audit Office, Government Control Office, Office for Economic Competition and courts.

Although a new Act came into force on 1 May 2004 (Act CXXIX of 2003 on Public Procurement), the original institutional framework remained in place, for the most part unchanged.

The Role of the Public Procurement Council

The structure of the Council is unique. It is made up of a full-time president and 18 members, of which equal proportions (six members each) represent:

a) Public interests.

b) The interests of the contracting authorities.

c) The interests of tenderers.

The Public Procurement Act establishes the framework of those organisations and persons that are eligible for appointing members to the Council. The members serve for a term of not less than two years and are not remunerated for their activity from the budget of the Council in order to ensure their independence.

The Council itself is an ad hoc body, meets yearly at least seven times (depending on the matters to be discussed). Its members have full-time jobs in their delegating organisations. Therefore the Council is assisted in discharging daily duties by two operational bodies: the Secretariat, the standing working structure, and, in the field of legal remedies, the Public Procurement Arbitration Committee. The employees of the Secretariat and the Committee are public servants.

The Council has been carrying out the following duties generally since 1995:

Public procurement policy and monitoring activities:

- Initiating legislation or amendment of the public procurement law.
- Making opinion on draft laws.
- Collecting statistical data.
- Preparing a report yearly to the parliament.

– Monitoring the execution of public procurement contracts.

Help-desk activities:

– Preparing recommendations, guidelines, etc.

– Making legally non-binding opinions on questions raised by the bidders or the contracting authorities.

– Supervising the public procurement training.

Collecting, controlling and publishing the public procurement notices

Operating the legal remedy system through the Arbitration Committee

Others:

– Maintaining international relations.

– Operating the official list of approved tenderers, the list of conciliators, the list of accredited attestors, the list of official public procurement consultants.

These duties include the publication of tenders, the operation of the legal remedy system and monitoring of the public contracts' implementation.

Controls made by the Council

Publication of tenders

According to both the previous and recent Public Procurement Act, the Council has been responsible for ongoing publication of public tenders and other related notices in its official bulletin (Közbeszerzési Értesítő). The contracting authorities are obliged to send tenders to the Council, which means there is no other official way of publishing notices, for example in a local journal or on the Internet. Since 1 May 2004, the date of Hungary's accession to the EU, tenders above EU thresholds should be sent to the Official Publications Office of the EU; at the same time however, it is possible to publish those notices in the national organ as well. Hungary was one of the new Member States that chose a solution in which the contracting entities should transmit the notices both above and below the EU thresholds to a central body (in Hungary's case to the Council), which dispatches the EU tenders to the OPOCE. The Editorial Board operating within the structure of the Secretariat carries out these tasks. Furthermore, the notices received are checked by legal revisers to ensure these legally fulfil the conditions set out in public procurement law. Should the revisers find a notice incorrect, they call the attention of the contracting authority to the possible infringement. If the latter sends the notice back and it is incorrect in the same way, this can be reported to the members of the Council who may initiate a legal remedy procedure.

Legal remedy system – Arbitration Committee

The Act on Public Procurement established the Public Procurement Arbitration Committee, "operating alongside the Council", as an independent body in charge of proceedings in legal disputes arising out of public procurement projects. In its character the Committee is a quasi-judicial body, more of an administrative authority than an arbitrage forum. The Committee is the only responsible review body; its power extends to the whole of the country, to every kind of public procurement. It covers both the classical

and utilities sector, and it has the necessary power to "control" not just the awarding procedures above the EU thresholds, but also those below them.

Its members – public procurement commissioners – chairman and deputy chairman are appointed and removed by the Council. The time period of the appointment of commissioners is not defined. Only persons who have at least three years' professional practice and have, additionally, passed a specialised law exam or a specialised administration exam may be commissioners. There are strict rules governing conflict of interest in the case of commissioners. Their independence is guaranteed by provisions in the law prohibiting their being issued any specific public procurement case instructions; they shall only consider the provisions in the law when executing duties.

The Arbitration Committee may proceed upon application or ex officio. It should be emphasised that any decision may be challenged – which is in connection with the contract award procedure and with Public Procurement law – but at the same time the Act gives clear rules on deadlines for submitting the request. The law provides generally 15 days for challenging a decision after the occurrence of the infringement, and eight days following the announcement of the final results. If the applicant learned of the infringement at a later date, the time limit shall commence at that point. Since the date of signing of the contract is not relevant, it is possible to question a decision even after the contract is concluded.

An application may be submitted by the contracting authority and any tenderers, candidates or other interested person whose right or legitimate interest has been violated or jeopardised by an activity or failure resulting from the infringement of the Act.

An *ex officio* procedure may be initiated by the following entities or persons on the grounds that they have, in the performance of their duties, learned of any behaviour or omission in violation of the Public Procurement Act:

a) A member and President of the Public Procurement Council

b) The State Audit Office

c) The Government Control Office

d) The administrative office of the county or of Budapest

e) The Hungarian State Treasury

f) The parliamentary commissioner (ombudsman) for civil rights, the parliamentary commissioner for rights of national and ethnic minorities, and the commissioner for data protection

g) The entity granting aid for the public procurement

h) The entity entitled to calls for tender in centralised public procurement

There are two more special rules that allow a legal remedy action *ex officio*: when a contracting authority fails to send yearly statistical reports about its procurement to the Council; when the application of negotiated procedures without prior publication of a notice and of simplified procedures is not justified. In Hungary should a contracting authority initiate such procedures, it should at the same time send information to the

chairman of the Arbitration Committee regarding the justified application of the given procedure.

The Committee judges in a group of three commissioners, appointed case by case by the chairman. The final decision should be taken within a maximum of 40 days. The review body may order interim measures upon request, such as suspending the procedure or prohibiting the signing of the contract and take *inter alia* the following legal action:

a) State that an infringement has taken place.

b) Before the closure of the contract award procedure, call upon the person who committed the infringement to act in conformity with the rules, or order that the contracting entity take its decisions only subject to certain conditions.

c) Declare null and void any decision made by the contracting entity, either during the contract award procedure or as a decision closing that procedure, provided that no contract has yet been concluded.

d) Prohibit the tenderer, for a period of up to five years, from participating in any contract award procedure.

e) Impose a fine on any organisation (person) that has violated the Act.

A claim for review can be submitted to the court against the final rulings of the Committee.

According to the statistics, the tenderers challenge from year to year on average every 5th or 6th contract award procedure.

Monitoring and controlling the implementation of public contracts

Since the new PP Act came into force in May 2004, contracting authorities have faced a new obligation: when the contract – based on an award procedure – is implemented or amended they should send a public notice to the Council in order to publish it.

The reasons for this provision are complex. The previous Act also often forbade modification of contracts having found such modification unjustified, and the non-contractual execution of the project had no real legal consequence.[1] The law provides the possibility for civil law actions against breach of contract – as in the case of "private" contracts – but in practice such cases were rarely encountered. Bidders are sometimes bigger and more powerful than the contracting entity, for example a small local government, and because of time pressure they tend to avoid bringing the case to court. Publicly publishing a notice can help reduce such malfunctioning of public procurements. In addition, the members of the Council may initiate legal remedy if they find an implementation or modification that goes against the rule. The Arbitration Committee should impose a fine if such action has valid grounds.

General audit bodies

Other organisations also play an important role in the field of public procurement. However, the State Audit Office, the Government Control Office and the supervisory bodies in the administrative structure mainly perform general budgetary control duties, and secondly designated audit in specific areas. At the same time the new Public

Procurement Act provides an obligation for regular audits in public procurement.[2] In addition to ex officio legal remedy procedures (see above), these bodies are entitled to launch remedies before the Arbitration Committee. The deadline for such action is extended for one year and three years if a public tender was unlawfully omitted.

Internal regulation

Before initiating an acquisition each authority should adopt a special internal regulation with regard to the procedure, naturally in accordance with the institutional provisions and rules on conflict of interest. (It is also possible to have a general regulation; if that is necessary it should be adjusted to the given procedure.) This internal law must contain at least the distribution of responsibilities and the documenting of the whole procedure and the internal audit mechanisms.

The Arbitration Committee imposes this regulation at the outset of a legal remedy in order to examine the accountability of the persons and bodies involved in the public procurement, which becomes relevant if an infringement is proved.

Notes

1 According to the effective law: "The parties can only amend parts of the contract drawn up on the basis of the invitation, the terms and conditions of the tender specifications and the contents of the tender if a circumstance violating a material legitimate interest of either party arises after the conclusion of the contract, due to a reason unforeseeable at the time of the conclusion of the contract."

2 "Public procurements and public contract award procedures are regularly audited by the competent audit bodies specified in the relevant legislation, in accordance with their roles and responsibilities and scope of authority, and they may initiate a procedure or measure in case of infringement. Public procurements and public contract award procedures must be audited according to the supervisory and internal audit system of the budgetary authorities set out in the relevant legislation" [Art. 308 (1)-(2)].

Chapter 19

Poland:

How the New Law on Public Procurement Implements the Anti-Corruption Recommendations of the Supreme Chamber of Control

by

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Poland's supreme audit institution, the Supreme Chamber of Control (SCC), has repeatedly pointed to irregularities in public procurement. The most common improper practices found during audit were the omission or non-application of the procedures required under the law, and the manipulation of calls for tender to ensure the contract is awarded to specific companies.

Since 2000 the Supreme Chamber of Control has been publishing special annual reports on the threat of corruption in light of its audit findings. These reports identify areas vulnerable to corruption and the mechanisms that create opportunities for corruption. Procurement orders have invariably been identified in these reports as an area in which there is a serious risk of corruption.

In the same reports, the SCC recommended legislative and organisational changes designed to tighten controls on procurement procedures. Among other measures, it proposed that the Public Procurement Office (the central government agency responsible for monitoring) be given greater powers, particularly where the procurement orders concerned are very lucrative. The SCC also proposed changes to appeals procedures, equal access to information on forthcoming invitations to tender, and greater procedural transparency.

As is the case with most supreme audit institutions in Europe, recommendations by the Supreme Chamber of Control have continually met with an inadequate response from government and parliament. Nevertheless, in the field of public procurement, the SCC's audits, comments and recommendations have, by dint of persistent repetition, proved effective. The 1994 Act on Public Procurement was amended, partially at first and later by a totally new Law on Public Procurement that took into account the majority of the recommendations made by the SCC.

Changes to the law on public procurement, which came into force in March 2004, mainly fall into the following seven categories:

1. Strengthening the publicity principle (transparency). Under the new law, "procurement contracts shall be open and shall be made accessible pursuant to rules laid down in the provisions concerning public information." This makes it more difficult to engage in unfair practices, as they can easily be discovered.

2. Wider procedural controls for public procurement: *ex ante* controls are now carried out by the Public Procurement Office for orders totalling more than EUR 5 million.

3. Introduction of an observer to scrutinise procedures for contracts totalling EUR 5 million. This is in line with the "many eyes" principle recommended by the SCC.

4. Introduction of a register of independent arbitrators to conduct an impartial review of appeals, questioning decisions by the committees awarding public procurement contracts.

5. Submitting for judicial review decisions in cases relating to the award of public procurement contracts.

6. Introduction of a legal requirement to publish information on the biggest procurement contracts in the national press.

7. Introduction of an electronic auction system to provide the public with access to information on forthcoming contracts via the Internet.

Thanks to these legislative changes, public procurement contracts are now more transparent, subject to tighter control, and free from mechanisms that can breed corruption. The SCC can legitimately congratulate itself on the fact that the recommendations it so persistently put forward have, in large measure, been heard.

Part III

Prevention, Detection and Sanction of Corruption in Public Procurement

This part provides an overview of the discussions that took place in two forum workshops, ***Identifying risks in the bidding process to prevent corruption*** and ***Compliance with anti-corruption laws through access to public procurement: sanctioning or voluntary self-regulation?*** The introductory chapters highlight the main findings of both the discussions and the written contributions submitted for the workshops. They are followed by the papers prepared by the workshop speakers. These two workshops were organised by Nicola Ehlermann-Cache of the OECD's Anti-Corruption Division, under the supervision of Patrick Moulette. Nicola Bonucci, Director of the Directorate for Legal Affairs, provided valuable guidance and ideas in the early planning for these workshops. Nicola Ehlermann-Cache and Helen Green reviewed this part of the publication.

Part III.A

Identifying Risks in the Bidding Process

Chapter 20	Main Findings of the Forum Workshop on "Identifying Risks in the Bidding Process to Prevent and Sanction Corruption in Public Procurement" Giorgio Sacerdoti Member of the WTO Appellate Body and Professor, Bocconi University, Italy
Chapter 21	Inventory of Mechanisms to Disguise Corruption in the Bidding Process and Some Tools for Prevention and Detection Jean-Pierre Bueb, Central Service for the Prevention of Corruption and Nicola Ehlermann-Cache, OECD Anti-Corruption Division
Chapter 22	Argentina: Identifying Risks of Corruption in Public Procurement Nicolás Raigorodsky Director, Bureau of Transparency Policies, Anti-Corruption Office, Argentina
Chapter 23	Latvia: Procurement Methods and Risks of Corruption in Public Procurement Diana Kurpniece Corruption Prevention and Combating Bureau, Latvia
Chapter 24	Mexico: Identifying Risks in the Bidding Process to Prevent Corruption Guillermo Haro Head of Procurement Standards, Mexico
Chapter 25	Asian Development Bank: Action to Identify Risks in the Bidding Process to Prevent Corruption A. Michael Stevens Principal Audit Specialist (Financial Investigator), Anticorruption Unit Office of the Auditor General, Asian Development Bank

Chapter 20

Main Findings of the Forum Workshop on "Identifying Risks in the Bidding Process to Prevent and Sanction Corruption in Public Procurement"

by

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Introduction

This workshop focused on identifying risks in the bidding process to prevent corruption. Discussions were structured around two major axes: mechanisms used to disguise corruption in public procurement and measures to prevent and detect corruption. An issues paper, prepared by Jean-Pierre Bueb of the French Central Service for the Prevention of Corruption, at the request of the OECD and in close collaboration with Nicola Ehlermann-Cache of the OECD's Anti-Corruption Division, details an array of these mechanisms and measures. This issues paper raised several questions for participants' consideration and provided a useful reference point for the discussions as well as the papers prepared for the workshop by panel speakers. All the papers submitted to participants are included in this part of this publication.

Speakers from Argentina, Latvia, Mexico and Pakistan clearly illustrated a wide range of fraudulent and corrupt acts in public procurement and methods to hide these malpractices through national examples. Numerous contributions from other participants confirmed that these techniques to commit and disguise corruption are pervasive in countries around the world, and that they concern both developed and developing economies. Participants also raised a number of interesting aspects specific to international procurement as well as procurement in special circumstances (*e.g.* post-conflict situations, massive privatisation) compared to local procurement. All stressed that the mechanisms described in the papers or mentioned during the discussion represent examples rather then an exhaustive inventory of the risks and mechanisms of corruption involved in public procurement.

With a better understanding of the issues and difficulties collectively faced by governments, international organisations, multilateral development banks and NGOs, participants turned their attention to effective means to prevent and detect corruption in public procurement in the second part of the workshop.

Informed by this thorough overview of national and international examples, discussions about the very nature of corruption and the fundamental purpose of the regulations that govern public procurement procedures led to a number of conclusions. Participants agreed on the need to redouble efforts to focus on corruption issues specific to public procurement. Specific needs included:

- Identification of the mechanisms used to conceal corruption.
- Improved mechanisms to share useful information (*e.g.* successful practices in fighting corruption, knowledge of cases or suspicions of corruption, identity of companies with a history of corruption) within and among government agencies; within and among international organisations; as well as across governments, international organisations and other stakeholders.
- Development of an operational guide that describes in detail a wide range of measures for prevention, detection and sanction of corruption in international public procurement.
- Specially conceived measures to address corruption in international procurement processes.

Mechanisms and risks

There are opportunities for corruption at every stage of the procurement process. From the initial steps of identifying project needs, conducting preliminary studies and drawing up specifications to the publicity and tender process, through to the execution and conclusion of any given project, there are clear risks and established methods of corruption. In the papers prepared for the workshop by the panel speakers, specific vulnerabilities and methods of corruption inherent to each phase of the process are outlined. The description of these risks and methods were complemented by numerous cases raised by other workshop participants during the discussions.

In determining project needs, mechanisms of masking corruption may include falsifying, underestimating or overestimating requirements to justify unnecessary work or purchases. Preliminary studies to assess and define what is required for a project may be themselves unnecessary, unused or unusable. Studies can also falsely conclude that particular services or goods are needed. A particular risk related to needs assessment, identified in a survey of public officials in Argentina, is the lack of an annual purchase plan, which regularly leads to situations where there is not sufficient time to assess needs correctly. As a result, needs become urgent and procurement processes are conducted under serious time constraints that could be avoided.

The stage of defining project specifications presents a particularly high risk for concealing fraud and corruption. Project specifications can be grossly under-estimated, so that the proposal is readily accepted. Necessary modifications are proposed at a later stage, once it is too late to proceed otherwise. When a product or service is essential and it is highly likely that the contract will be awarded, specifications can also be over-estimated. At the end of the project, there is a balance, which may be diverted or reported publicly, creating the impression that the decision-maker is a particularly skilful project manager. Hand-tailored specifications can limit participation and favour a particular manufacturer or contractor. In addition, rating criteria can prioritise one aspect over another in order to influence the contract award. For example, the criterion of past awards with the same contractor can be assigned a high weighting, 30% or 40%, so that the particular contractor is more likely to win the tender. These mechanisms allow contracting authorities to award contracts to the preferred bidder while maintaining a facade of compliance with proper procedure.

There are methods to commit corrupt acts that are particularly adapted to the bidding process. Collusive agreements, *i.e.* anti-competitive behaviour that arises when businesses agree amongst themselves, for instance, the prices they will set and who will win which contracts, may in turn lead to corrupt behaviour. Collusion and associated corruption can also take place between bidders and public officials. A noteworthy example of collusion and corruption in a bidding process was reported where the favoured company, among four bidders, was called to the bidding appointment by the contracting authorities one hour in advance. However, just before the bidding was to take place, a bomb scare was received and the other bidders did not arrive at the venue. As the only bidder present, the favoured company was awarded the contract. Upon investigation, it was found that the bomb scare was a hoax and that the consultants, in fact, were precisely where the bomb was reported to be. Other less spectacular examples also demonstrate the link between collusion and corruption. The management of privileged, sensitive information between bidders and officials is an area where collusion can arise. In an example of a large, river dredging contract, the company awarded the contract had been secretly advised to omit the value-added tax from the bid, information

that was not conveyed to other bidders by the decision-making agency. Several examples of collusion among bidders were also raised.

Corruption can also manifest itself in the publicity of tenders. A multilateral development bank cited an example where the favoured contractor and the government agency had colluded to create a fake advertisement to give the bank the impression that the tender had been properly publicised. In another example, a company bought all 25,000 copies of a local newspaper in which the sought after tender was advertised.

Corruption can take place throughout the execution of a contract. A participant gave examples of corruption in the form of misappropriation of goods; situations where supplies obtained via a sound procurement process disappear. Goods can be diverted either to officials for their private use, or diverted for resale, especially to companies who will later submit tenders for the same or similar projects. Goods or services provided can be of a lesser quality than stipulated in the procurement contract. A multilateral bank representative explained a situation that is prevalent in international procurement where contracts are awarded and prices agreed upon based on the reputation and renown of international companies. However, the work is actually carried out by local, inexperienced consultants or sub-contractors and is often of very mediocre quality. Another mechanism observed in the execution phase is front-loading. Front-loading consists of concentrating the majority of the contract activities in the early part of the execution either with the intention of not finishing the project or in the hopes of increasing the price of the original contract.

Sub-contracting was identified as an area where the risk for corruption was particularly high. Even where procurement regulations are observed throughout the initial phases of the process, there is often little or no vigilance over the relationship between the winner of the contract and eventual sub-contractors. This mechanism may present further risks for corruption when sub-contractors themselves sub-contract work, or when sub-contractors are based in offshore tax havens.

Many cases of corruption in public procurement involve conflicts of interest, a topic addressed in Workshop 2, *Improving transparency in public procurement*, as well. In some cases, selection commissions or control authorities lack independence. In other cases, the promise of future employment of a public official, or his or her relative, with an interested company bears great influence on procurement decisions. Conflicts of interest were observed in massive privatisation processes, where companies that run previously-public utilities are able to influence the appointment of the public officials responsible for auditing. A related phenomenon, referred to as *pantouflage* in French, involves former public officials who move to the private sector, namely to the companies they once audited.

Some participants stressed the important link to be made between corruption in the procurement process and corruption in the political process. Rather than a bribe, the corrupt act takes the form of a donation to a political party.

Prevention and detection

Much of the difficulty in detecting corruption in public procurement stems from the fact that there is often no clear victim nor perpetrator, rather a group of individuals in collusion, with common interests in maintaining secrecy around their corrupt acts. In addition it must also be acknowledged that the established procedures and the regulations that govern public procurement are designed to increase competition and to ensure the

quality and timely delivery of products and services. Prevention and detection of corruption are not primary objectives of public procurement regulations.

Participants pointed out that often times in their experience, situations involving corruption have every appearance of conforming with regulations, and that only through lengthy, persistent efforts, specially designed to discover corruption in public procurement, could wrongdoings be revealed.

There is a range of measures that can be effective in preventing corruption in public procurement. Approaches to prevention include introducing or strengthening managerial and administrative measures, control and audit procedures, rules and procedures that promote ethical behaviour and transparency in the procurement process, warning and alert systems and penalties for involvement in corruption as well as increased cooperation and information-sharing. Examples of such measures were presented by panellists and others still were raised in the workshop discussions.

Staff training was mentioned on numerous occasions as an important element in the prevention and detection of corruption. Both multilateral development banks and national procurement bodies reported on their efforts to increase awareness among staff and train personnel on ethical issues and responsibilities concerning corruption as well as on regulations governing procurement and the common warning signs of fraud and corruption. The resulting increase in the number of concerns, allegations and complaints is a positive outcome of these efforts.

Effective controls specific to corruption in public procurement procedures require specially trained people to identify patterns or suspicions, and gather and share information. A good illustration is the specially trained field staff of a multilateral development bank, based in a country reputed for widespread corruption, who work exclusively on the review procurement documents. While these specialised employees are not investigators formally speaking, they are very knowledgeable in the local languages and customs and are skilled and experienced in performing basic checks, identifying trends and comparing documents in search of irregularities and collusion.

Several participants emphasised the need to implement audit procedures that go beyond the customary control measures implemented in procurement processes. Normal supervisory and oversight systems, in terms of financial specialists, procurement specialists, field staff, are very often unable to detect corruption. Discussants differentiated between two main types of audits. The first type is an audit of companies' books and records, revealing how they conduct business and carry out controls. These audits are especially useful to identify and map out specific risks for corruption. The second type is an account audit. These audits consist of detailed investigations of a company's stocks and orders, in search of specific irregularities. Account audits are far more complex, far more likely to detect corruption, and require auditors with very specific expertise.

Risk analysis is an important tool to enable authorities to allocate better their time and efforts to fight corruption. The anti-corruption office of Argentina developed a tool to diagnose the risks of corruption through a survey of high-ranking public officials on their views of important risks and vulnerabilities in the procurement procedure. Mapping out risks within an organisation, through thorough auditing, can provide important insight into potential sources of risk (*e.g.* procedures, personnel), control prevention measures in place and whether they are effective, and additional efforts that are required.

Many of the governments and organisations represented at the workshop have put in place rules and procedures that promote transparency in the procurement process (some of these procedures are described in more detail in Part II. A.). For example, the Latvian government has implemented an appeal system whereby no work can begin during the seven days following the award of a contract, allowing time for information or suspicion of wrongdoing during the bidding process to be reported. Mexico's Internet-based system for government contracting, Compranet, promotes transparency in the bidding process by making procurement information accessible to the general public. Terms of tender can be obtained via the Internet and for 40% of all federal government bidding processes, bids can be submitted via the Compranet Web site. Future upgrades will allow users to find information on the evaluation of bids, the award results, the formalisation of contracts and the progress of work. In Argentina, draft terms of tender and draft contracts for large contracts are regularly the subject of broad consultations with the general public and with private sector actors. This open approach has provided useful feedback, for example, on whether specifications were not sufficiently broad, favouring one or only a few companies.

Information-sharing and cooperation – among agencies within governments, among governments, and among international organisations – were raised as important elements in the global stand against corruption. The identity of companies, particularly sub-contractors, with histories of corruption; past involvement in fraud and corruption on the part of government officials or employees of international organisations; and reports of suspicions are only some examples of valuable information that could benefit a range of actors in their efforts against corruption. However, participants noted that in many cases this knowledge is simply not passed on. Information-sharing among all stakeholders with the common goal of preventing and detecting corruption should be facilitated. Knowledge of successful practices, useful experiences and other sources of helpful information should be communicated broadly.

Whistleblowers, people who come forward to disclose information on corruption to state officials or to the media in the public interest, are a critical source of information and an important part of corruption investigations. These individuals need assurances that they will be protected from the possible consequences of coming forward with information – exclusion, legal prosecution, or sometimes even threats of violence. Measures for confidentiality and immunity must take into account however the risk of false declarations by individuals, themselves corrupt, who bring bogus accusations against a company for the benefit of its competitors.

Measures for the detection of corruption were touched upon, though only briefly given the time constraints of the workshop. These measures include red flags, indicators, and warning systems. Examples of typical warning signs cited by participants included excessive modifications during the execution of a contract, or abrupt, obvious changes in public officials' lifestyles that might signal involvement in corruption. Participants agreed that further discussion and guidance on warning signals and systems to transmit the suspicions to the authorities would be useful. Nor did time allow for an extensive discussion of sanctions, other than mentioning their importance as a dissuasive measure. Participants' view was that further work on developing effective sanction procedures is needed. Sanctions were discussed in further detail in the workshop on ensuring compliance with anti-corruption laws through access to public procurement. The main findings and papers from this workshop are in Part III.B. of this publication.

Increased risks for corruption and mechanisms associated with international procurement

The examples of risks and mechanisms explored in this workshop can apply to both local and international procurement. Some methods however, are more relevant to one type than the other. A number of factors characteristic of international procurement warrant particular attention to understanding and addressing the specific risks and mechanisms for corruption.

International public procurement most often involves international business transactions with large, multinational corporations and their subcontractors. It also typically involves large, complex contracts, often consisting of several contracting stages or elements. These stages or elements may necessitate a number of suppliers or service providers, and their various contributions to the project may be over several phases that must be coordinated and timed. Control mechanisms should be expanded and adapted to address these specific features of international public procurement processes.

Sub-contracting in international public procurement can create opportunities for corruption and presents its own challenges in terms of auditing, particularly in cases where subcontractors themselves, in turn outsource services. Companies' accounts cover a wide variety of projects in many countries, which can facilitate hiding corruption. Financial channels are more complex, often involving routing through tax havens or offshore centres. These additional complexities are coupled with the added difficulty for domestic auditors and investigators to review foreign documents.

Yet another added intricacy specific to international procurement procedures, is the wide range of actors that can be involved. Procurement procedures that take place between two or more countries often involve the services of agents or intermediaries. These consultants typically work with a number of different companies and projects to facilitate transactions between potential providers of goods or services and public administrations in exchange for a percentage of the deal. The risk for corruption in this context is significant and it is extremely difficult to monitor the activities and commissions of these agents and intermediaries.

Multiple jurisdictions and sets of procurement regulations make detection and prosecution of corruption more difficult. A corrupt individual could use this lack of uniformity in procedures to his or her advantage.

Certain special situations may increase the risk of fraud and corruption. For example, in post-conflict situations, emergencies, or in areas undergoing significant shifts in social policy or political regimes, the tasks of defining project needs and specifications, evaluation, tendering and auditing may become much more difficult. Procurement officials are often hampered by the sheer volume of logistical matters to be managed; absence of independent, reliable information; and difficulty in assessing needs in emergency situations. Widespread privatisation of public utilities including water, electricity, telephone and transportation, is another situation that presents unique challenges. Because of the importance of these services to the population and the vast amounts of money that are usually involved in such privatisations, these processes call for especially strong controls.

The role of financing institutions, including multilateral development banks, the European Union, and United Nations organisations, in public procurement is complex. On one hand these organisations are responsible for most aspects of defining, planning

and evaluating projects as well as overseeing the execution of the project and the disbursement of funds. However, their mandates, powers and jurisdictions vary greatly. In many cases, they are limited in the extent to which they can call for audits or investigations and the degree to which they can debar companies or apply sanctions. For example, multilateral development banks, as administrative organisations, can exercise administrative sanctions (see Part III.B.). They do not, however, have the *subpoena* powers or the prosecutorial powers of governmental agencies. The success of these institutions' efforts to fight corruption relies to a great extent on cooperation with law enforcement, other state agencies and with other organisations.

Chapter 21

Inventory of Mechanisms to Disguise Corruption in the Bidding Process and Some Tools for Prevention and Detection

by

Jean-Pierre Bueb and Nicola Ehlermann-Cache*

* This paper was prepared by Jean-Pierre Bueb, French Central Service for the Prevention of Corruption (SCPC), at the request of the OECD and in close collaboration with Nicola Ehlermann-Cache of the OECD's Directorate for Financial and Enterprise Affairs, Anti-Corruption Division. Views expressed herein are those of the authors; they do not necessarily reflect those of the SCPC nor those of the OECD.

Public funds may be misappropriated to serve private interests in every country, across many sectors of activity. Given the amounts involved, public procurement contracts require particular attention in order to prevent misappropriation.

Corruption is not the rule in public procurement, however. It is caused by a limited number of dishonest public officials and business people seeking to obtain personal advantage. The potential risk of corruption may be greater in international procurement than in domestic procurement, especially because of the value of contracts and the number and variety of players involved. Finally, it may be noted that in many cases of corruption which come to justice, regulatory means have been deflected from their true purpose.

Various mechanisms used to camouflage corruption in public procurement are reviewed in the first part of this paper. The second part, drawing on the understanding of risks specific to the different stages of the public procurement process, considers possible preventive measures. Various techniques that facilitate the misappropriation of funds are described in Annex 21.A. Questions are raised throughout the paper to encourage reflection on other types of fraud and corruption, further means of preventing corruption and identifying factors indicative of corruption.

I. Mechanisms used to disguise corruption in public procurement

Corruption may take place at any stage in the process of tendering for, awarding and performing public contracts for works, supplies or services. Various forms of corruption can be identified throughout the four principle stages of the public procurement process:

a) Identification of needs.

b) Definition of specifications.

c) Awarding of the contract.

d) Performance of the contract.

1. Mechanisms used during the identification of needs

It has been observed that before a contract is put out to tender, during the phase of determining project needs, two methods may be used to favour one candidate over another. The first is to distort or falsify needs so that projects can be launched which are unnecessary or bigger than planned. The second method is to commission onerous or unjustified studies.

Modified or falsified needs

Changing or falsifying needs is a way of justifying purchases, works or services that are often unnecessary or disproportionate to actual needs. The initiators of the project outline the justifications of needs in an explanatory report. In many cases these project officials can only be reprimanded for benign "mistakes" such as wrongly estimating stocks, replacing equipment that could have been repaired or failing to look for alternative solutions. However, these justifications can conceal corruption.

Unnecessary, falsified or subjective studies

Studies are often essential in order to identify needs, but can also be used for corrupt ends. Examples include small-scale studies commissioned from a favoured firm without consultation or studies that are commissioned but never delivered or claimed, even though advances have been paid. In some cases, several organisations submit identical studies, simultaneously or over a period of time. For example, an initial study is commissioned from a competent organisation. The results of the initial study are then passed on to fictitious firms that plagiarise them, generating very substantial margins that can be shared with the decision-maker through a slush fund, using false invoices (see Annex 21.A.).

Instead of commissioning studies from independent organisations, the decision-maker can have them carried out in-house. Internal units may bias their studies. Deliberate omissions can then be used later to justify an award of contracts. Usually this leads to a negotiated procedure, which is generally unpublicised and is without competitive tendering.

2. Mechanisms used during the definition of specifications

It has been determined that there are many ways of concealing corruption in the process of drawing up specifications. However, they are not easy to identify, particularly when controllers are not familiar with the technical aspects of a given project. Claims, especially those made by unsuccessful bidders, must be checked quickly and thoroughly so as to ensure that controllers are not used unknowingly to eliminate a chosen candidate.

Misevaluated project estimate

The project estimate is a crucial and often complex element in the procurement process. In the most complex cases, the project is estimated in two stages: a summary estimate formulated at the same time as the initial study and a final estimate, drawn up together with the specifications. A contract estimate can be deliberately under- or overstated. Underestimation is frequent and can unduly facilitate the authorisation to begin a project. The necessary supplements will subsequently inflate the initial cost, because the winner of the initial contract will inevitably be the beneficiary of the supplements, which are rarely negotiable, generating substantial margins that facilitate corruption.

Purchases or works may be overestimated when the decision-maker is certain that a contract will be awarded. The awardee of the contract will thus have a comfortable margin, part of which may be returned to the decision-maker without increasing the initial cost. The decision-maker may even be perceived as a good manager and re-elected for another term, since the project required neither re-evaluation nor supplemental costs.

Preference for a single supplier

A single supplier may be favoured for a contract. Two methods are frequently used to justify awarding a contract to a given firm: choosing services covered by an exclusive right; or commissioning studies or specifications from an operator linked to a group, another of whose subsidiaries will then bid for the contract. In the second case, the subsidiary has exclusive access to information that other bidders do not have.

Inaccurate data

The intentional use of inaccurate data can conceal corruption. In this case, a favoured firm is told about incomplete or inaccurate information deliberately included in the specifications. The firm may discount a particularly onerous condition in its estimate and win the contract by making a bid that is lower than other bids but provides for a higher margin nevertheless. In another example, a firm makes a low overall bid to win the contract but charges high unit prices for the goods or services needed to continue the work, without a new tender. The additional work, carried out by the contractor and paid at the stated unit price, generates a substantial profit.

Excessive specifications

Imposing specifications that are much more rigorous than general standards can be another method to disguise corruption. In this technique, the official responsible for certifying the work is an accomplice. The official states that the work is in conformity with specifications, when in fact it is not. As long as the work meets generally accepted standards, safety certification agencies do not conduct further inspections.

Imposed requirements for maintenance

Some equipment and material need maintenance that can be provided only by an installer with an exclusive right. In such cases the purchase contract is negotiated on particularly advantageous terms, but the maintenance is later carried out under conditions imposed by the supplier. This technique is encountered particularly in contracts involving computers and office equipment.

Another technique along similar lines is the purchase of state-of-the-art equipment that is incompatible with the decision-maker's existing equipment. At some point, the decision-maker will be obliged either to make expensive modifications to make existing equipment compatible or to replace it completely.

3. Mechanisms used in the awarding of the contract

The most frequent offences in the awarding of contracts involve circumventing the application of regulations. The main techniques to conceal corruption are splitting contracts, reducing publicity, misusing procedure and skewing selection criteria.

Split contracts

This method consists of splitting a large contract into several smaller ones that are not subject to public procurement regulations. The same firm does all the work but the bills are submitted under different company names. In the case of several companies taken over by a competitor, this is very easy, as acquired companies maintain their own distinct identity.

Reduced publicity

Splitting contracts can also reduce competition, especially from foreign firms by circumventing the requirement for publication of calls for tender (in the Official Journal of the European Union, for example).

Fraudulent operators can reduce publicity in other ways, such as publication in a journal with limited circulation or in domestic journals only or by making false claims of

urgency that requires a shorter tender period. Wrongdoers can eliminate publicity entirely by using as justification spurious legal grounds such as state secrecy, exclusive rights, research or experimental work or additional supplies.

Misuse of procedure

There are two types of misuse of procedure that deserve particular attention: an open but inconclusive call for tenders and a restricted call for tenders.

Given that it is difficult to know the outcome of an open call for tenders, and in order to reduce the risk of an unknown bidder beating a favourite, the tender procedure is replaced by a negotiated procedure. The reason generally put forward for not awarding a contract on completion of the tender procedure is that the bidders' prices exceed the total envelope available.

A restricted call for tenders is justified in principle by the technical complexity of the operation or by the existence of patents or exclusive processes. However, the procedure may be misused in order to eliminate rivals, since in some cases work is sub-contracted to firms that do not have the required qualifications.

This procedure may also give rise to conspiracies between candidates on a list of possible tenderers. It is a real danger, since mergers and acquisitions have reduced the number of specialists, whether for works, supplies or services. It can also be noted that it may be perilous to try to break up a conspiracy, since the claimed "victims" can bring a complaint against the decision-maker for favouritism.

Biased criteria

Some of the bid selection criteria contained in public procurement regulations may be deliberately chosen for their subjective nature, enabling the classification of bids to be changed. This is the case, for example, with the "architectural aspect" or "environmental appropriateness" of a project. The criteria may also be revised by the members of the awarding commission when the bids are opened, for example by creating or modifying weightings allocated to each criterion or by adding further criteria.

Inability or failure to apply penalties

In certain cases it may prove impossible to sanction failure to comply with specifications, either because the necessary clauses have been removed from the contract or because the decision-maker does not enforce them.

Omission of mandatory clauses

Mandatory clauses are sometimes inexplicably omitted from the specifications or contractual documents, especially the general administrative terms. They are often penalty clauses for non-compliance with terms or conditions of the contract, such as missed deadlines, modification of equipment between order and delivery, obvious computational errors, etc. These omissions cannot be mere oversight, because the master documents used to draw up the contract contain all these clauses; and several deliberate steps must be taken in order to eliminate them.

Non-enforcement of penalty clauses

Where penalty clauses do exist, fraudulent intent may be revealed by the contracting authority's failure to take action against contractual non-compliance. If the amount of

work has been wrongly estimated or essential services have not been provided, the fault generally lies with the contractor, design firm, technical controller, etc. and not with the contracting authority. Yet no steps are taken to sanction the initiators, despite the contractor's claims and the need for supplements to the initial contract. On the contrary, as the initiators' profits are proportionate to the volume of work, they are actually rewarded for their faults.

4. Mechanisms used during the performance of the contract

Many aberrations may occur during performance of the contract, though this no longer falls within the scope of public procurement procedure. Various methods may be used, whether in contracts for works, services or supplies, some examples of which are given here.

Misappropriation of supplies

Misappropriation in the delivery of supplies may take several forms and can occur, for example through discounts, changed orders, or through the return of equipment.

Discounts

Discounts, whether promotional, quantitative or other, can be paid to the buyer personally and not to the organisation the buyer represents. The technique is as follows:

- An account is opened with the supplier in the buyer's name and credited with discounts that have not been included in invoices. The buyer can use the credit to purchase what he or she wants. The goods concerned do not appear in any inventory because they have no legal existence.
- The discount is paid into an account that is not exactly that of the contracting authority but of an association linked to the buyer (the name of which is very similar to that of the authority), thereby providing parallel structures with money or equipment.
- Promotional products are delivered directly to the buyer: for example, if a fourth item is offered free for the purchase of three, three products are bought, paid for and delivered to the authority at the normal price while the fourth, which is free, is delivered later to another address.

Changed orders

Modifying orders is another way to misappropriate funds. A product is ordered and billed. Just before delivery, the supplier is asked to change the order for a less expensive product. The bill drawn up according to the initial order is sent to the authority. As the price is higher than that of the goods actually delivered, the supplier posts a credit equal to the difference to an account in a name similar but not identical to that of the authority.

Improper or undisclosed disposal of used equipment

Misappropriation can also occur in the return of computer or office equipment. Upon the purchase of new equipment, a buyer must dispose of used equipment. It is generally sold or taken back by the supplier in return for a small discount. If the equipment is still in working order, it is dismantled and taken to a warehouse for destruction. The cost of dismantling and transporting the equipment is equal to the amount of the discount.

The firm to which the contract has been awarded thus finds itself in possession of goods that have no commercial value, as the acquisition price is equal to the cost of dismantling and transport, but are in working order. It can dispose of the equipment for cash, without leaving a paper trail, since this transaction would not appear in the accounts. This money can either be used to create a slush fund (see Annex 21.A.) or can be passed on to the buyer.

Irregular service provision

Aberrations can also arise in the provision of services. The mechanisms are generally more sophisticated than techniques used in the purchase of supplies. These techniques include modifying services or multiple payments for the same service.

Inappropriate changes

After a contract has been awarded, the decision-maker and the service provider may agree to reduce the services contained in the specifications so that a commission can be paid (see Annex 21.A.). The savings generated can then be returned to the decision-maker in cash or in kind (maintenance of a private residence, for example).

For intellectual services, the commissioner and the service provider may come to an oral agreement to limit the service provided. This can significantly reduce the amount of work while complying with the obligation to provide interim or progress reports which generally trigger the payment of advances.

Multiple payments

Another mechanism consists of ordering a study that already exists. This form of recycling is particularly profitable and generates substantial sums to be shared among those involved. This method is simple to use, can be used several times in succession, and is difficult to detect without prior knowledge of the original study, published under a different title.

Performance of works via multi-level sub-contracting

The involvement of a large number of firms, either members of a consortium that has won a contract or a group of sub-contractors, can multiply the possibilities for fraud. Cascade sub-contracting is an easy way to conceal fraud, and may occur at any stage of construction (groundwork, transport of materials, modified or incomplete work, etc.). Additional works covered by a supplement to the initial contract can radically transform the initial financial reckoning.

Box 21.1. Discussion questions on mechanisms used to disguise corruption in public procurement

The mechanisms used to disguise corruption that described in the preceding section do not constitute an exhaustive list. Comparing and discussing experiences and reflection on the following questions may help identify others.

Are the mechanisms described in the preceding section relevant to all public procurement?

What other mechanisms are there?

What features are specific to different types of procurement?

Are there mechanisms that are used more often in international public procurement? If so, what are they?

II. Preventive measures and indicators of suspicion

Knowledge of accounting and the main mechanisms used to disguise embezzlement can contribute to preventing corruption in public procurement. This understanding can also help identify and establish indicators to confirm suspicions of corruption. With this information, law enforcement officials can carry out enquiries and investigations more effectively.

Some ideas on preventive measures and possible indicators follow. This set of possible measures and indicators is not exhaustive and can be expanded upon in the light of different experiences.

1. Measures to prevent corruption

There is a wide variety of means to prevent corruption that includes:

- Applying managerial measures, such as changing organisational structures after a risk has been identified.
- Applying administrative measures, such as replacing a person identified as presenting a risk.
- Introducing or strengthening effective control procedures, such as internal and external controls by auditors, the judiciary and competition authorities.
- Implementing procedures or drawing up rules that favour transparency in notices of calls for tender, decisions, etc.
- Introducing simple and effective warning systems that do not penalise whistleblowers.
- Encouraging the implementation of policies to assess whether firms involved in corruption should be allowed to take part in public procurement procedures.
- Introducing or strengthening ethical rules and penalties for public officials or entities involved in corruption.
- Introducing or strengthening procedures for alerting prosecutors of credible evidence of corruption.

Box 21.2. Discussion questions on measures to prevent corruption

Are there other means of prevention and, if so which ones are particularly effective?
Do the means to prevent corruption vary for works, supply and service contracts? If so, what factors or differences have to be taken into account so that different tools can be developed?
Do specific means of prevention need to be introduced to prevent corruption in international public procurement procedures? If so, which ones?

2. Indicators

The introduction of analytic indicators relating to the public procurement process, from the launch of calls for tender to performance of the contract, should help establish control points for public officials.

The public procurement procedure

Data currently gathered in all countries allow the establishment of statistical tables containing a range of relevant information, such as:

- The number or amount of contracts awarded to a given firm or supplier (suspicion of favouritism).
- A list of firms whose bids are systematically rejected because of price or quality of service, but who are ultimately sub-contractors of the winning bidder (suspicion of conspiracy).
- Frequency of open or restricted calls for tender that are ultimately inconclusive, ending in a negotiated procedure (suspicion of favouritism).
- Abnormal extension of the lead time between award of the contract and effective signing of the contract or service order. The firm can use this time to revise prices and determine how it can find the money demanded by the decision-maker after awarding the contract, either by cutting margins or by reducing the services provided. (suspicion of corruption).
- Existence of links between the decision-maker (or an employee) and the contractor (suspicion of illegal interest).

Box 21.3. Discussion questions on indicators of suspicion in the public procurement procedure
Are these examples of indicators relevant?
Should other indicators be formulated? If so, what other indicators would be relevant?
Are different indicators needed for international public procurement contracts? If so what other indicators would be relevant?

Structure and management of the awarding entity

Indicators concerning the internal organisation of the awarding entity can also be developed in order to draw up a "risk map". An audit can identify:

- Activities where risk arises (preparation of specifications, for example).
- Personnel who are potential sources of risk (technicians, decision-makers, technical managers, for example).
- Measures taken to elude controls (lack of internal controls for all contracts below a certain threshold, for example).
- Measures that exist in name only (purely nominal controls of the contract by the legal department, for example).
- Measures that result in certain persons having powers that exceed their capacities (for instance a technician who has designed the project who is ultimately responsible for monitoring the procurement procedure and performance of the contract).

Various questions can be asked in preparing this type of risk map:

- Do formal procedures exist for awarding contracts?
- Are there internal controls?
- Are controls independent of the decision-maker?
- Do delegations of signature exist? are they formalised?

The independence of control organisations is a fundamental issue. While it may be presumed that the indicators used by external controllers may arouse suspicions that will subsequently lead to a more thorough enquiry, there is nothing to suggest that an internal audit or risk map will contribute to improve the existing process. It may well be that the manager who receives the internal audit report has no genuine interest in improving transparency in the procurement procedure.

Box 21.4. Discussion questions on indicators related to the structure and management of the awarding entity

Are there other identifiable risk factors? Are there specific risks linked to the international nature of certain contracts?
What elements of international procurement require special attention?
What other questions need to be asked to identify the strengths and weaknesses of organisations involved in public procurement?

Annex 21. A.

Techniques for Misappropriating Funds

There are several methods to misappropriate the funds gained through corrupt practices. Some main methods are described below.

1. Slush fund

Within an economic entity, a slush fund is used to collect and distribute money to fund corruption pacts. In its most basic form, it consists solely of cash. In more sophisticated forms, it is managed through bank accounts generally situated in other countries, preferably tax havens (see section 6 below). In order to make the system more opaque the accounts may be managed by a trustee.

The effectiveness of the system relies on concealment. The assets in the slush fund have to be acquired secretly, without being subject to taxation. Consequently, the exclusive objective of all the techniques used to feed the fund will be to give the appearance of legality to criminal practices.

2. False invoices

An invoice is a document which justifies a charge in the accounts of an industrial or commercial entity as well as its corollary, a disbursement. The document may be real (a true invoice), entirely fictitious (when nothing is provided in return for the consideration) or partly false (over-billing or, in some cases, under-billing).

False invoices are used to extract money from an entity by presenting an ostensibly genuine and justified document, when in fact it is at best only partially true. A false invoice can thus be integrated into the client's and supplier's accounting systems as the consequence of a real service rendered, with all the characteristics of formal consistency between the two sets of accounts. The invoice triggers payment by the customer and hence authenticates a disbursement.

False invoices are often used for sales of goods and studies. Falsification in the sales of goods can consist of an increase in the number of items sold, an increase in the unit price or modification of product quality. Falsifications in studies may include an increase in one of the parameters that determine the cost of a study (*e.g.* work carried out by the firm's employees, work sub-contracted to a third party, machine time, travel expenses, secretarial costs, copying, binding, etc.).

3. Commission

Commission is the remuneration received by an intermediary who carries out a transaction or facilitates or completes a commercial act on behalf of a third party. Paying commission is perfectly lawful. However, it is possible that commissions be paid (on the

basis of invoices) to intermediaries whose fees have been substantially inflated or who have done nothing at all.

The use of commissions has several potential advantages.

- Commissions can be paid on all economic operations, such as increasing sales, completing a real estate transaction, renegotiating debt, making fruitful and confidential investments, making a purchase on advantageous terms that increase the profit margin, etc.
- Commissions maximise the utilisation of funds and are always favourable in financial terms since it enables almost all of a sum to be used as intended. Its profitability is certain in relation to other arrangements that may be equally effective but cost more because they need complicities that have to be remunerated.
- Payment of commission is flexible and easy to set up. A single supporting document makes it possible to "launder" a substantial disbursement. In addition, from a fraud standpoint it justifies charging an expense for a purpose other than the general and exclusive interest of the company – an expense that would normally be inadmissible.

Two types of commission are generally found in public procurement: disguised and intermediation commission.

- Disguised commission takes the form of a perfectly genuine service, often the preparation of a bid, which the firm did not in fact need. The company providing the service is genuinely qualified and has the means to carry on its business. However, because it overcharges for its services it has to increase its outgoings, which it can do by paying false invoices (thus generating cash disbursements) or by paying salaries to people whom it does not actually employ.

- Intermediation commission is paid for the mere fact of bringing a contracting authority and a contractor together. In public procurement, it seems that the intermediary, informed by the contracting authority or decision-maker, is kept informed of the award of contracts. An intermediary's activity consists solely in issuing invoices that correspond to a percentage of the value of the contract equal to the amount of the commission demanded by the decision-maker plus his or her own remuneration. The money is received and immediately redistributed. The operational arrangements are identical to those for other commission payments. The intermediary may operate on a regional, national or international scale.

4. Advertising agent

An advertising agent is a commercial structure that undertakes to raise advertising funds on behalf of its principal, in the context of managing a magazine or other periodical publication (generally monthly or quarterly). The system generally involves four players:

- An association or municipal, regional or other body that has created the magazine or publication.
- A limited circulation magazine financed by advertising.

- An agency which both solicits advertising and handles the layout and printing of the magazine.
- Advertisers.

The owner entrusts the management of the magazine to an agency that publishes and distributes it, and finds the advertisers who will pay for it. The search is conducted by brokers who are recruited by the agency and paid a commission. If the brokers are effective, the agency can in some cases pay a percentage of its profits to the owner of the magazine.

The misuse of the principle described above derives from the fact that the magazine has no impact in advertising terms and is used solely as a vehicle to raise money. Furthermore, the owner of the magazine is part of a network and has a portfolio of potential clients willing to buy advertising space in the magazine. Thus, on the one hand there is a client who is willing to pay a certain amount and on the other an initiator who is willing to receive it. It suffices then to simply give the arrangement an appearance of legality.

Using an advertising agent is an additional and complementary arrangement for any operation that needs to use cash. It is a very flexible technique, both geographically and institutionally, and highly elaborate at all stages, perfectly suited to the management of substantial sums of money.

5. Undeclared labour

Undeclared labour is prevalent in all labour-intensive sectors of the economy. Three main systems are used for undeclared labour.

A company uses undeclared workers alongside its declared employees, or has its employees carry out undeclared work. Undeclared work is paid in cash, while declared work generates the employees' official salaries. The system entails undeclared transactions, concealed activity, and a slush fund to pay for it.

Temporary employment agencies bring greater flexibility to this arrangement. On a construction site, for example, there may be two types of temporary employment agency: well-known agencies and little-known, short-lived entities. The use of the latter allows well-known agencies to reduce or eliminate taxes, social security charges and VAT. Such an arrangement is necessary when a firm that has lawfully won a contract at very precisely calculated prices is obliged to pay an unforeseen commission to the decision-maker. In these cases the company must find a cash feed among only those elements contained in the contract.

Some foreign companies illegally "import" staff from their home country without meeting the statutory requirements of the country where the work is done.

6. Tax havens and shell companies

The use of structures located in other countries, especially offshore tax havens, amplifies the effects of these mechanisms.

Tax havens have several characteristics of considerable interest to fraudulent operators: low or non-existent taxes on income, corporate profits, capital and inheritances, and company law and banking regulations that enable shell companies to be created very quickly and easily.

In a tax haven, it is possible to quickly and easily create or dissolve legal entities or other legal structures whose effective beneficiaries are unknown (shell companies) and to obtain advice from highly competent people. As the country is not a signatory to any international convention, it does not apply any rules that enable commercial transactions to be tracked or financial intelligence exchanged.

Shell companies and tax havens are thus a means of carrying out the manœuvres described above with complete discretion and in all impunity. The mere fact of routing a simple commercial transaction through a shell company in a tax haven, by adding an intermediary to the chain, means that purchase prices can be inflated and sale prices reduced so as to set up a tax-free slush fund in the country concerned that can be used either for the manager's personal benefit or to pay bribes.

Even given the measures taken by the OECD to combat the payment of commission in international commercial transactions, this particularly simple mechanism operates effectively: the shell company has no link with the company that has to pay the bribe, which cannot therefore be added to any black list. If the arrangement is discovered, only the shell company will be convicted, and it is very easy and cheap to create another one to carry on the illicit activity. Many other means exist; a dozen of them were listed in the 1996 report of the French Central Service for the Prevention of Corruption.

Given the quality of advice and the performance of the banking system in a tax haven, this "detour" is a means of building up assets abroad, managing funds (which can be used anywhere in the world thanks to bank debit cards), reinvesting in the home country (using intermediaries who manage the funds – trustees – through kinds of joint-stock corporations) and passing on assets to beneficiaries cheaply and easily.

Chapter 22

Argentina:

Identifying Risks of Corruption in Public Procurement

by

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Introduction: the situation at the turn of the new century

Corruption and lack of transparency in public procurement are important problems in Argentina. Presidential Decree Nº 1023/2001 is the general regulation for public procurement. This decree gained the legal status of a Congressional Law through a delegation of power in the Economical Emergency Act of 2000. The contents of this law are relatively sound and could help ensure the transparent management of public procurement but its one-of-a-kind nature has generated a lack of legitimacy that affects its application. In addition, several contradictions among various lower level procurement regulations also contribute to poor public procurement procedures. Finally, rules for acquisitions of organisations such as the World Bank or the Inter-American Development Bank are more dynamic and are seen by decision makers to be shortcuts to bypass standard public procedures.

There are some general issues that create opportunities for corruption in public procurement.

- Lack of control mechanisms: the absence of regulatory agencies, vague competencies and ad hoc regulations.
- Discretionary powers: the absence of reasonable limitations on the range of officials' discretionary powers to make decisions on the allocation of public funds.
- Lack of transparency: the failure to create or apply rules that grant citizens and NGOs access to public information leads to a lack of transparency may allow for corruption.

There are also specific factors that can lead to wrongdoing in procurement. In 2000, the Anti-Corruption Office of Argentina researched causes of corruption in two major administrative processes: public procurement and selection for public positions. Senior ranking public officials from acquisitions departments of major federal agencies were surveyed on specific risks for corruption in public procurement. The procurement process was divided into five phases:

1. Identification of needs.
2. Definition of rules for bidding and publicity of the calls for tender.
3. Award of the contract.
4. Performance of the contract.
5. Auditing.

Officials believed that each phase presented serious risks of corruption. Almost all of them identified risks of corruption throughout the procurement process, however, always within agencies other than their own.

Main risks at each stage of procurement were identified as follows:

1. Identification of needs: absence of a purchase plan; lack of control over budget implementation; some agencies' special privileges concerning use of funds; impediments for the inclusion of new competitors; overestimation of needs.

2. Definition of rules for bidding and publicity of the calls for tender: absence of standard models for bidding rules; lack of training on procurement rules and mechanisms for public officials; bureaucracy; opaque management of critical information; coexistence of various procurement regimes.
3. Contract award: priority of formal requirements over substantial evaluation of offers; absence of contractors' records; cartelisation of bidders; union pressure to obtain concessions.
4. Contract performance: absence of impact measurement, delivery of low quality services; divestment of goods or services to purposes other than those established; absence of penalisation for incomplete work.
5. Auditing: lack of independent controlling agencies, inability to prevent wrongdoing because controls are performed after the fact.

The survey results showed the need for consistent, long-term work to increase transparency in public procurement. However, a significant number of those surveyed were concerned that increased transparency would result in increased bureaucracy and inefficiency. Agencies involved in transparency in procurement should always be vigilant for ways to make transparency and efficiency work together well.

Some mechanisms to commit corruption identified in the survey are further developed in this third part of this paper. Examples are given for the earlier stages of the procurement process: identification of needs, definition of specifications and contract award. No examples of corruption in auditing phase are cited in this paper.

Privatisation and corruption in the 1990s

During the 1990s public corporations and enterprises in Argentina went through a massive privatisation process. At this time the public generally believed that state operation of companies was synonymous of corruption and inefficiency. This was, in general, true. However privatisation proved to be an inadequate solution to corruption problems. In fact, these privatisations provided huge opportunities for corrupt behaviour. There were allegations of corruption as a major factor in the awarding of public contracts in almost every privatisation process. Many of the companies that obtained contracts were multinational corporations. These international biddings took place before the entry into force of multilateral agreements against corruption like the Interamerican Convention against Corruption of the Organization of American States or the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Several cases denounced by the Anti-Corruption Office to the judiciary are related to corruption cases during privatisation or concession of public services. In many of them, major international corporations were involved.

The risks of corruption in large international biddings can be illustrated in the concession of the public service of dredging and maintenance of a long portion of the Paraná River from the Port of Santa Fe to Buenos Aires, known as the Hidrovía contract. In this case, main international dredging companies took part in a bidding process to win the concession, finally awarded to a Belgian firm. The original contract term was 14 years but through a series of economic claims, the company obtained a contract extension of 8 years as compensation. Such an extension should have been the subject of a new bidding process, but the new contract was awarded directly, without a competitive procedure, to the corporation that won the original contract. This dredging contract is considered to be

very valuable in the international market because of the revenues for the managing firm. In this case, it is difficult to determine whether corruption occurred. What is certain, however, is the lack of transparency throughout the process.

There are other examples, for instance the privatisation of control duties over radio electric spectrum. In the unusual case of the privatisation of the police, normally under state control, serious allegations of bribery were raised. This contract, awarded to a French company, resulted in spending untold millions for services that, according to allegations, were never performed. Other bidding procedures followed the same pattern. Poorly designed bidding rules resulted in the delivery of deficient services and claims of supposed breaches of contract obligations by public authorities from favoured contractors.

Mechanisms used to disguise corruption in public procurement

Specific cases of the use of mechanisms to mask corruption in different stages corroborate the risks identified by procurement authorities listed previously. Selected examples follow.

Mechanisms used during the identification of needs

Insufficiently defined needs in budget planning

Distortion of needs is one of the central problems in procurement management. The link between the definition of needs and the formulation of the budget for the following year is key issue. There is a serious failure in accurately defining future needs that, in some cases, provides ample opportunity for corrupt behaviour. In Argentina's procurement law, the general mandate is to procure through public biddings. This procedure is meant to guarantee an open process and ensure a high number of firms participating in public procurement.

In the absence of adequate procurement planning, many agencies decide to acquire goods or services directly, through direct negotiation without opening the bid to competitors' offers. The rationale for this approach is often reported to be urgent needs that arise very late in the planning process. Direct purchases do not always equate to corruption. Public managers maintain that in many situations, following procurement rules is slow and bureaucratic. But repeated violation of rules, particularly those that establish open bidding for purchases, can usually be linked to inflated prices and unknown companies who have influence among public officials. In some cases, these new, unknown companies are owned by direct relatives of the head of an agency and have no experience in the field of work they are being contracted to perform. On many occasions, the same companies fill a suspiciously wide range of roles, depending on the nature of the services required by the corrupt public agency.

A properly designed procurement plan would help uncover these and other opaque manoeuvres and is a key tool in the fight against corruption.

Unnecessary, falsified or subjective studies

Studies are often indispensable for a successful procurement process. At times, however, needless studies are carried out. In other cases, studies are performed by consultancy firms that have a relationship with the company or companies that will

participate in the bidding process. As such, the studies not only generate the need they are intended to identify, but also create an illicit advantage for a firm or a group of firms.

Mechanisms used during the definition of specifications

A study conducted by the Anticorruption Office in 2000 revealed that the phase of drafting specifications is highly susceptible to corruption. There is little opportunity for controllers to detect corruption that takes place during this phase.

Preference for a single supplier

A public official can easily favour one competitor over the others by including specifications that can only be met by that particular bidder; and hand-tailored specifications are believed to be a frequent occurrence. Highly specialised, technical aspects of specifications present a difficult challenge to officials responsible for control activities. In most cases hiring an expert to assess technical aspects exceeds the budget. As a result, scrutiny of specifications is often merely formal. NGOs encounter these same difficulties when they participate in monitoring procurement processes.

Hand-tailored specifications can also be the result of a lack of experience on the part of civil servants responsible for the procurement process. Public officials at times simply duplicate the specifications used for preceding contracts. In these cases, it is not a question of corruption, but simple inefficiency.

On other occasions, specifications are formulated from a catalogue of one of the firms that may participate in the tender. Often, the specifications are more strict than necessary, limiting the number of bidders and making the contract needlessly more expensive. The costs increase because of lack of competition and excessive specificity of the products.

An example of inappropriate specifications is illustrated in the procurement process for the supply of food to a federal penitentiary. Until 2001, the public officials of the penitentiary Service (SPF) were responsible for the management of food services. The SPF purchased raw materials and prepared food for detainees. In the process prices were inflated, officials stole large quantities of food and prisoners received extremely poor quality meals. At the same time, a food distribution mafia emerged inside the prison, with the complicity of the SPF members.

In 2001, the Anti-corruption Office proposed to improve the situation by contracting the food services to a private firm. An open bidding process was organised and draft specifications were published on Web pages and in national papers for comments from interested parties. The first draft, drawn up by the SPF, sparked numerous observations, especially concerning specifications that would have unnecessarily limited participation. The results of the process overall were excellent: the service was privatised, costs decreased, and the quality of the food greatly improved – as reported by an NGO survey.

Inaccurate data

Management of sensitive information concerning bidding processes is always a risky area, particularly as concerns publicity and access to information. Surveys indicate that is very common for one or more bidders to have access to information that is not available to the rest of the bidders. The nature of the illegally unveiled information varies, but it always provides an advantage over those who are not privileged to the information.

In the Hidrovía case, one of the bidders was secretly advised to present an offer without adding the value added tax (VAT) to the price for services to be delivered. The rest of the bidders added the VAT to the offers, following an ambiguous reply on the issue given by a project official. The firm that had been informed in advance submitted the best offer overall (without VAT) and was awarded the contract.

Mechanisms used during the award of the contract

Split contracts

In some cases, agencies divide a contract into parts, so that they will be exempt from an open bidding process. Because smaller contracts are not subject to public tender or broad publicity, decision makers can award these contracts to "ghost" companies. This type of corruption occurs most frequently in supplies contracts. In many cases, it is clear that contracts are split to avoid legal obligations regarding publicity. Examples include cases where agencies purchased a large quantity of personal computers; but instead of buying all of them in one process, they split the contract in several direct purchases, avoiding an open tendering process. Another case is the implementation of a security system where the work was divided into separate parts with no justification. In both cases, all the divided contracts were awarded to the same company.

Chapter 23

Latvia:

Procurement Methods and Risks of Corruption in Public Procurement

by

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Every year thousands of public procurement contracts are concluded in Latvia. In 2003, the amount of public spending for procurement contracts was LVL 501 million,[1] (approximately EUR 790 939 000 or USD 863 691 000) an amount approximately equal to one-fourth of the state budget. Considering the large sums of state and municipal government funds at stake, the potential for corruption in public procurement and means to prevent and detect wrongdoing in public procurement are extremely important issues.

In Latvia, procurement procedures are specified by two pieces of legislation. The Law on Procurement for State or Local Government Needs, which came into effect in 2002, outlines procedures for public procurement. Law 257, Procurement Regulations for the Needs of Public Services Providers specifies procedures for granting contracts for services, supplies and construction works for public services providers (*e.g.* water works, electricity, gas, public transport and postal services), where "public" refers to a company where the state or a municipality holds at least 50% of the enterprise's assets.[2] These regulations, issued by the Cabinet of Ministers, meet the requirements of the European Parliament and Directive 2004/17/EK.[3] In order to receive European Union Structural Funds or Latvian state resources, private persons are required to follow the procedures specified in relevant legislation to ensure transparency in procurement and the most advantageous tenders for the lowest price, thus ensuring effective use of funds.

There are two institutions involved in monitoring compliance with the laws and regulations in the area of public procurement in Latvia, the Procurement Monitoring Bureau (PMB) and the Corruption Prevention and Combating Bureau (CPCB). The PMB was established in 2002 upon the enactment of the Law on Procurement for State or Local Government Needs. Its main mandate is to monitor compliance with the laws and regulations in the areas of public procurement and procurement for the needs of public services providers. The PMB is the initial point of contact for bidders and others who file complaints or suspicions of wrongdoings in the procurement process. It organises educational workshops to raise awareness on public procurement legislation and provides methodological support to contracting authorities. The CPCB detects and examines violations of procedure in public procurement. It conducts further investigations of complaints passed on by the PMB and other sources. Its Division for Examination of State and Municipal Affairs, created in January 2003, works together with the PMB to monitor compliance with the Law on Procurement for State or Local Government Needs. It also examines other state and municipal institutions' affairs, including the use or lease of public property.

Procurement methods

According to the Law on Procurement for State or Local Government Needs, there are five procurement methods in Latvia. The method used is a function of the estimated contract volume and/or the type of procurement, as illustrated in table 23.1. Methods defined by the law must be applied if the amount of the contract exceeds 1 000 LVL. The Law on Procurement for State or Local Government Needs stipulates that if the procurement is for a supply or services contract valued between 1 000 and 10 000 LVL, or for construction works up to 50 000 LVL, procurement must be undertaken via price quotation. If the amount for a supply or services contract exceeds 10 000 LVL, or for construction works exceeding 50 000 LVL, methods of open or restricted competition must be applied.

Table 23.1. Procurement methods and application according to the estimated contract value

According to the Law on Procurement for State or Local Government Needs

ESTIMATED CONTRACT PRICE (LVL)	PROCUREMENT METHOD				
	price quotation	***open competition***	***restricted competition***	***negotiated procedure***	***competition of sketches of projects***
1 000 to 10 000	supply contract or contract for services			supply contract, contract for services, or construction works	
over 10 000		supply contract or contract for services	supply contract or contract for services	supply contract, contract for services, or construction works	contract for construction design or elaboration of draft designs for territorial planning
1 000 to 50 000	contract for construction works			supply contract, contract for services, or construction works	
over 50 000				supply contract, contract for services, or construction works	

The difference between open and restricted competition is that in a restricted competition there are two levels of evaluation: evaluation of applicants and evaluation of offers. Application of a negotiated procedure is not based on estimated contract prices, but depends on other factors. Examples where negotiated procedures are applied include a lack of time due to unforeseen circumstances beyond the control of the contracting authority (fire, natural disaster, war, epidemic, accident, etc), situations where the contracting authority needs to exchange or supplement goods already at its disposal, or where tenders for open or restricted competition have not been submitted.

The Procurement Regulations for the Needs of Public Services Providers set forth three methods of procurement – open competition, restricted competition and negotiated procedure – applicable according to whether the procurement amount exceeds contract price limits defined by the European Union. These procedures must be applied for supply or services contracts that exceed 282 459 LVL or for contracts for construction works that exceed 3 530 732 LVL, as illustrated in table 23.2. Many public services providers apply these procedures even for amounts that fall below the compulsory thresholds, although there are no legal requirements to do so.

Table 23.2. Procurement methods and application according to the estimated contract value for the needs of public services providers

ESTIMATED CONTRACT PRICE (LVL)	PROCUREMENT METHOD		
	open competition	*restricted competition*	*negotiated procedure*
more than 282 459	supply contract or contract for services	supply contract or contract for services	supply contract or contract for services
more than 3 530 732	contract for construction works	contract for construction works	contract for construction works

Risks of corruption in public procurement

Changes in legislation

Since the Law on Procurement for State or Local Government Needs came into effect in 2002, it has been substantially amended three times. The Cabinet of Ministers has introduced changes to the Procurement Regulations for the Needs of Public Services Providers as well. These frequent changes have caused difficulty in creating a common understanding of the legislation and in educating contracting authorities. In its investigations of procurement procedure violations, the CPCB has found that employees of contracting authorities, especially municipalities, often have a poor knowledge of procurement legislation.

Risks in the definition of specifications and selection criteria

Most errors and violations committed by contracting authorities relate to tendering documentation, in particular project specifications or descriptions of work. These contraventions can be due either to a lack of knowledge or an explicit intent to circumvent or violate regulations.

Biased criteria that favours selected bidder(s)

One of the most frequently cited violations of procurement legislation is the inclusion of requirements in tendering documents that may favour one or a few bidders. Two such examples are requiring licenses that are unnecessary or unrelated to the work and requiring a list of specific goods to be acquired that corresponds to only one bid.

Insufficiently defined selection criteria

The use of insufficiently defined selection criteria for offers is another common risk in the procurement process. Only those criteria defined in the tender documents or in the Law on Procurement for State or Local Government Needs may be used in the selection of applicants. Selection criteria that are not disseminated to all applicants beforehand may not be applied, even in cases when there are several similar offers and selection is difficult.

Misuse of procedures

There are opportunities for corruption that arise in the inappropriate application of procurement procedures, as observed by the CPCB.

Split contracts

In some cases the estimated amount of work, the quantities of goods to be obtained or the estimated contract price is artificially divided in order to circumvent competition regulations. According to the Law on Procurement for State or Local Government Needs, the procedure for procurement at lower prices is fairly straightforward. The documentation and announcement requirements are simpler and less expensive than requirements for competition procedures.

Misapplication of price quotation procedures

In price quotation procedures, contracting authorities are required by law to invite at least three applicants. These invitations are the only mandatory publicity for price quotation procedures, greatly decreasing the likelihood and extent of oversight from competitors. In some cases, contracting authorities take advantage of this situation by inviting companies who are inexperienced or unqualified in order to justify awarding the contract to a favoured bidder. In other cases, preliminary agreements have been made with the desired candidate.

Prohibited agreements

Collusion among candidates for a contract and collusion between candidates and contracting authorities have been reported by the media and by bidders themselves. Parties involved in collusion rarely disclose information; and it is difficult to prove such violations. In cases when there are grounded suspicions of collusion among candidates, the contracting authority can decide to terminate a procurement procedure. In these cases, this information on suspected collusion must be submitted to monitoring authorities.

Absence of procurement procedure

There are cases where procurement contracts are concluded with no procurement procedure at all. The PMB has observed that this practice is common among municipal institutions, either due to lack of knowledge or in an attempt to avoid due procedures and rules of fair competition. No announcements are made for such contracts hence information can be obtained only from audits, competitors or local citizens. Along with the application of inappropriate procedures, this has been found to be the most frequent violation of procurement legislation identified by the authorities.

Abuse of complaint and appeals mechanisms

The PMB has established a complaint mechanism by which bidders can file their concerns or suspicions of possible violations of procurement procedures. While this mechanism has proven useful in detecting corruption, some companies misuse the mechanism to file unfounded complaints as a form of revenge on the selected bidder.

The submission of a complaint suspends the competition and delays entering into a contract for about one month, until the complaint has been reviewed. Both the PMB and the CPCB receive complaints, an estimated 20% of which are ultimately found to be baseless after investigation.

Conflicts of interest

There is a risk of conflict of interest between members of procurement selection commissions and bidders, particularly when commission members may have a business relationship with potential bidders.

In order to prevent conflicts of interest, procurement commission members have been required to be registered as state officials since 2003. State officials have liability for conflicts of interest and are subject to criminal law in cases of passive bribery. The Law on Prevention of Conflict of Interest in Activities of State Officials prohibits state officials from awarding a procurement contract to an applicant for whom they work. Before each procedure, members of the procurement commission must certify that they have no personal interest in the outcome of the competition.

Others, who are not commission members, may still exercise influence over procurement decisions, however. This is very difficult to ascertain. For example, the opinion of a director of an institution may influence decisions of a chairperson or members of the commission.

Difficulty or inability to apply penalties

Although several sanctions for violation of procurement procedure are provided for in the Administrative Penal Code, the application of these penalties is difficult in practical terms. First, regulations on the application of administrative fines are outdated. Only courts or state police have the authority to impose administrative charges for violations of procurement procedures. These charges are practically impossible to apply given the very short period of negative prescription, currently just 4 months. In some cases, detection of violations can take a year or more.

Even more difficulties arise in applying criminal law. According to the law, criminal charges can be brought against a person suspected of having committed a criminal offence, *i.e.* intentionally or through negligence having committed an offence prohibited by the criminal law and that offence having all the required constituent elements of a criminal offence. The most difficult aspect in applying criminal law in cases of procurement procedure violations is proving the intention to commit the alleged violation. Additionally, it must be proven that the state official committed the intentional act by using his or her official position in bad faith, and that such an act caused substantial harm to the state authority, administrative order or those rights and interests of persons, which are protected by law. In cases where no substantial harm can be identified, no criminal liability arises. So far there has been only one case where a public official, an officer of the National Armed Forces, was found guilty of bribery and of using his official position in bad faith in procuring arms and other goods. This person intentionally violated the Law on Procurement for State or Local Government Needs by providing two companies the opportunity to enter into a contract.

Action taken to combat corruption in public procurement in Latvia

The Law on Procurement for State or Local Government Needs and the Procurement Regulations for the Needs of Public Services Providers are the legislative pillars of efforts to combat corruption in public procurement in Latvia. The Procurement Monitoring Bureau (PMB) and the Corruption Prevention and Combating Bureau (CPCB) are the principle drivers behind these efforts. Both institutions have taken concrete action to address the problems and risks associated with public procurement.

Because the public procurement structure is mainly decentralised and autonomous for each authority, each institution involved in procurement needs to have expertise in public procurement procedures. Therefore education is an important priority in the area of public procurement. In 2003, the PMB organised 95 procurement legislation workshops, attended by over 2 000 participants, to raise awareness and train contracting authorities.

The PMB examines competition regulations in cases where potential non-compliance is signalled by bidders, or upon its own initiative, particularly when a company has been the subject of several complaints. To help ensure a common understanding of the law and to prevent mistakes in drafting competition regulations, the PMB has also developed examples of competition regulations which have proven very useful in the work of municipal and regional institutions.

Between 1 January 2004 and 30 June 2004 the CPCB received and examined approximately 110 applications and complaints from individuals and legal persons. During this same period, the CPCB received about 121 complaints from the PMB and 79 decisions of the Complaints Examination Commission. In 27 cases, it was decided to investigate the complaint further. Currently there are 81 cases under examination.

The CPCB's Division for Examination of State and Municipal Affairs has developed a database of contracting authorities that have been the subject of repeated complaints, for internal use. The public procurement activities of these contracting authorities and their head officials are the target of reinforced scrutiny. The Division also examines property-related and financial affairs of these risky contracting authorities listed in the database, working in close cooperation with the State Audit Office, the State Revenue Service, the economic affairs police, the finance police and the Ministry for Regional Development and Municipalities.

The CPCB has drafted amendments to the Administrative Violations Code that would increase fines for violations of procurement procedures, clarify terminology, broaden the scope of liability and eliminate existing loopholes. Unfortunately, this draft legislation has not yet moved forward as there is insufficient support from authorities.

Work to strengthen the future efforts against corruption in public procurement is well underway. The State Program on Corruption Prevention and Combating (2004 – 2008), adopted on 3 August 2004 by the Cabinet of Ministers, contains essential proposals for improving the legal framework and will further enhance institutional cooperation. At the beginning of 2004 the Cabinet of Ministers adopted the Concept on Use of Information Technologies Improving Public Procurement System and detailed regulations and laws are currently being drafted. The introduction of e-procurement systems will improve transparency and accountability of procurement procedures. The announcement of tender, reception of tender documentation and submission of applications will be possible in electronic form. The system will also permit e-bidding with descending step and centralisation of some procurement in order to achieve the best price for public institutions.

Notes

1 Latvian lats. 0.63342466 LVL = 1 EUR, 0.58006849 LVL = 1 USD. Average exchange rate for 1 January-31 December 2003, The Bank of Latvia.

2 Latvia was the only acceding country to European Union to have adopted a separate, effective legislation on procurement for needs of providers of public service. Procurement Monitoring Bureau, www.iub.gov.lv, visited 21.10.2004.

3 Directive 2004/17/EK of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal sectors.

Chapter 24

Mexico:

Identifying Risks In The Bidding Process To Prevent Corruption

by

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Public procurement in Mexico

The general procedure for contracting purchases, leases, public works and services in Mexico is public bidding through public tender, as established by Article 134 of the Mexican Constitution. Public bidding procedures help secure the best conditions as to price, quality, financing and punctuality for the state. They also help guarantee transparency and fair, non-discriminatory treatment in government contracting. Currently, approximately 40% of federal government contracting is carried out through public bidding procedures. In 2003, procurement contracts totalling USD 26 billion were signed in Mexico. In the first half of 2004, contracts amounting to USD 35 billion were awarded. Of these contracts, 53% were for services, 24% for public works, and 23% for purchases.

Laws on procurement, leasing and services for the public sector, laws on public works and related services issued in 2000 and regulations issued in 2001 are the framework for application of Article 134. These laws provide for corrective sanctions of public officials, bidders, suppliers and contractors both for corrupt acts and for omissions in the procurement process that result in damage to federal property.

Public bidding through public tender is an open procedure. Information on the various stages of the bidding process – the tender, the terms of the tender, the submission and opening of bids, the results of the technical and economic evaluations, and the award of the contract – are published in the official federal gazette and posted on the electronic system for government contracting, Compranet, accessible to interested parties, supervisory authorities and the general public. The procedure is also publicised in the media, thus the government's procurement plans are public knowledge, which provides protection against excessive discretionary powers on the part of public officials and opacity in the contracting process (see also Chapter 11).

Box 24.1. E-procurement in Mexico: Compranet

Compranet is Mexico's electronic, Web-based system for government contracting. This system receives 20,000 daily visits and 7,000 terms of tender are downloaded every day. Compranet makes it possible to obtain the terms of tender, to participate in tenders issued by the federal government and to follow the bidding process on-line. Around 40% of the 30,000 annual federal government biddings can be submitted via Compranet. The government is committed to making this mode of bidding possible for 100% of bidding processes in 2005.

Compranet is an important means to promote transparency and further upgrades and improvements are planned. The next stage of upgrading will allow all contracting procedures to be conducted through this system, not only the bidding process. In addition, users will be able to find information on all aspects of the procedure, including the evaluation of bids, the results, the award, formalisation of the contract, and will also be able to follow the progress of work to its completion.

Some stages of the process, however, are reserved only to those who purchase the terms of the tender and participate in the bidding process. Only these parties have access to the results of the technical and economic evaluations and only they can take the floor at meetings for clarification of the terms of tender. Also, only those who have purchased the terms of tender may express an objection concerning irregularities in the bidding process committed by public officials. Anyone may file a general complaint with the authorities concerning a violation of the laws; however, this rarely occurs.

Critics of the public bidding procedure claim that it does not guarantee the best contracting conditions for the state and that it is inefficient because of the time involved in preparation, publication, evaluation of bids and the award. This belief is one of the primary risks of the public bidding process. However, the process is inefficient only to the extent to which there are inefficiencies in planning and scheduling of contracting, formulation of the terms of tender, establishment of participation requirements, and most importantly, the method for evaluating bids. In almost every contracting process, a simple method of evaluation is used where all goods are considered equal; and contracts are awarded based on the lowest price. The laws do not explicitly require contracting at the lowest price, nor is the highest price a guarantee of quality, punctuality or materials. In addition, some believe that because public bidding is an open procedure, applicants who may not necessarily have the required competence nor solvency could be awarded federal public contracts.

Some of the main tools used to address these issues are the formulation of standard terms of tender, prior inspection of the terms of tender by the secretariat of public administration, and constant, intensive training of the personnel in charge of contracting. Relevant requirements are included in tenders to avoid the risk of awarding contract to incompetent or insolvent applicants. Another practice to improve the bidding procedure is the posting of terms of tender on the Internet prior to their publication in the official federal gazette. Anyone interested in the tender can express an opinion or suggestion about the project to be contracted or the established requirements. The issuer of the tender is required to respond to this input, and where suggestions cannot be taken into account, he or she must indicate why. In addition, business associations and specialists in the field are invited to review the preliminary terms of tender. However, at this stage, there is still relatively little response from the public. It is generally agreed that measures to improve this process are needed.

The public bidding procedure entails risks of corruption because it is precisely in the bidding process where it becomes most difficult to detect and prove corrupt acts. There are several potential scenarios where corruption can occur. The examples listed below have been observed in Mexico.

Risks for corruption

Insufficient justification of goods or services to be contracted

The laws on procurement and on public works establish that requirements must take into account the national development plan, technical programmes, administrative support, the fiscal and financial calendar, maintenance requirements, and the short-, medium- and long-term goals and objectives, among other factors.

Lack of compliance with these rules can result in onerous purchases of goods that are never used or only partially used. Other possible consequences include the acquisition of information technology projects that do not work and consultants' services and studies that are ultimately useless. This area calls for stronger preventive oversight.

Inappropriate requirements

Some requirements established in the procurement procedure needlessly limit or hinder manufacturers' participation. Examples are requests for certifications (*e.g.* ISO certification, Microsoft quality assurance) or audited financial statements that are unnecessary for or irrelevant to the evaluation of the bid. Nonetheless, failure to submit

these documents and fulfil these requirements can lead to the disqualification of the bidder. Other examples include the requirement for payment of international tenders in Mexican currency or for bids to be submitted exclusively in Spanish, which constitutes an incorrect application of International Commerce Terms (Incoterms).

In some cases excessively rigid requirements are imposed intentionally so that there are no suitable bids, in order to cancel the tender and call for an exceptional procedure, in which these requirements are then eliminated or relaxed. Despite the emphatic exclusion of restrictive aspects by the law, some restrictions do exist; the requirement for the exclusive use of the Spanish language is an example.

To combat these inappropriate restrictions, proposed reforms to the laws on procurement and public works call for a clear indication of the relevance and purpose of established requirements and how the requirements will be used in the evaluation of bids. In addition, the acceptance of bids in languages other than Spanish will be included in the draft reforms. The proposed reforms also stipulate that if an exceptional procedure is called for as the result of a failed tender, the fundamental requirements established in the terms of that tender cannot be eliminated or relaxed.

National versus international tenders

Another risk is encountered in the issuance of a national tender for the procurement of goods, when it should be international; for example, if the goods are not manufactured in Mexico.

Contracts for various stages of work

In contracting for information technology projects that develop over stages, there is a risk that after the first phase of development, the only option for the purchase of subsequent modules will be the winner of the initial, lowest-priced contract. In this type of contracting, requirements are established that favour a particular brand or supplier, particularly those already certified and involved in the project.

Captive third party market

The result of the bidding process may create a captive third party market. This is a particularly difficult risk to manage. For example, when equipment is installed on private property, it is the property owner, and not the federal government who is captive to a supplier. This market can amount to several million dollars.

Excessive technical requirements or testing

At times, unjustifiably advanced technical requirements are imposed that result in under-utilisation of equipment. Examples include photographic or computer equipment where processor speeds are unnecessarily fast for the operations for which they will be used. With regard to tests, some requirements call for excessive measures, such as testing all the lots of produced goods. To address this issue, it is very important to have a standards or official specifications included in the terms of the tender. In Mexico, the standardisation process is being strengthened.

Shortened deadlines

Shortened deadlines, both for the submission of bids and for the delivery of the goods, services or completion of construction works, are considered by law as

exceptional cases. Indicators have been established to measure how many tenders are issued within shortened time limits. In order to obtain a good rating according to these indicators, a tender should not have shortened deadlines.

Other circumstances

In matters related to safety and hygiene, a risk may arise when union representatives are part of the committees that decide on the characteristics of the goods to be purchased, or when services are contracted from the unions themselves. There are risks in contracting for services or public works when it is actually a matter of the purchase of goods. In these cases, the goods manufacturers are excluded.

Conclusion

One resource for combating unlawful acts is the mechanism to signal and respond to unlawful irregularities in the bidding process. In 2003, the Mexican Federal Public Administration conducted more than 42 130 bidding processes, in which 2 676 irregularities were signalled, representing 6.35% of the bidding processes. Of these cases, 451 were considered to be in order. Approximately only one out of every 100 bidding processes featured irregularities that resulted in the partial or total invalidation of the process.

The federal government has taken a number of actions to combat corruption and improve transparency and to respond to the risks observed in bidding processes in Mexico. The use of information and communication technologies is expanding. Compranet, for example, will continue to be further developed and improved. Other measures include the introduction of witnesses and social observers, the formulation of standard terms of tender, the certification of purchasing agents, the responsible use of the complaint mechanism, and the utilization of the simulated user, among others. Reforms to the laws on procurement and on public works, as well as the establishment of codes of ethics, integrity and conduct in federal government agencies and in business associations and chambers of commerce are being actively promoted. In addition, indicators to measure transparency and non-limitation of bidders, as well as the efficiency and effectiveness of the bidding procedure have been developed.

Chapter 25

Asian Development Bank:

Action to Identify Risks in the Bidding Process to Prevent Corruption

by

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"Corruption wins not more than honesty." This quote is from William Shakespeare's Henry VIII can imply there is always hope the "good" and "right" may prevail over "evil" and "wrong." This will happen with a competent and comprehensive programme to address fraud and corruption in public procurement, even in places with very high perceptions of corruption.

There are innumerable forms of and venues for corruption; however, by far the most potent remains procurement. This is not a new phenomenon. For example, in the case of the United States, a voluntary disclosure programme of the US Securities and Exchange Commission revealed that 117 of the Fortune 500 companies made more than USD 400 million in "questionable payments to foreign concerns" during the first half of the 1970s. The US Foreign Corrupt Practices Act of 1977 (FCPA), which prohibited transnational bribery and the associated tax deductibility, was an attempt to address that problem. As a consequence of the FCPA, the US Department of Commerce figured US firms lost nearly 100 foreign contracts worth USD 45 billion to foreign competitors in 1994-95. That impact was for just one year. One can only imagine the extent of corruption worldwide and its impact on the world economy in general, as well as the peoples of the developing world in particular.

As an auditor and investigator for the Asian Development Bank's Anticorruption Unit, I deal daily with accusations of fraud and corruption related to public procurement. Sometimes it is government officials and bureaucratic decision makers complaining against contractors and consultants—the buyers complaining against the suppliers. Other times, the reverse happens, when the suppliers complain against the buyers. Sometimes, the buyers, suppliers, or civil society will complain about a third-party, often those institutions that fund those procurements. The problem with corruption in procurement is that it is very difficult to prove, or indeed disprove. If there were only two parties directly interacting—the consumer and the provider—corruption would never be an issue. Only when there is third party or where the purchaser is really not the consumer or end-user does corruption become an issue.

But what is public procurement? It is essentially a business process, with considerations of integrity, accountability and transparency, national interest and effectiveness, but all within a political system. Thus, without political support nothing can change. To lay the blame on government officials and bureaucratic decision makers—the buyers—as the tools through which bribery, fraud, or other corruption is channelled, however, would be inadequate at best. At the same time, if the political will is there but there is insufficient expertise amongst the buyers then, too, nothing can change. What is required is both political will and expertise to generate the right environment to combat corruption in the procurement process.

Sometimes the change comes in unexpected ways. The United States launched a programme to reinvent government in 1994, and one of its first tasks was to reform the laws of its procurement system. Obviously, one benefit of this reinvention was increased efficiency in public procurement. A corollary benefit, however, was that by removing bureaucratic obstacles in public procurement, government reduced the incentive for the private sector to cross the line in its attempts to commit fraud or corruption. In 1998, the United Kingdom followed suit and began its own study on Efficiency in Civil Government, which resulted in several improvements in their procurement system. France, too, undertook procurement reforms. Through those measures billions of dollars were saved.

So, are major overhauls of bureaucracies necessary to address corruption in public procurement? Certainly that is not the case. There are so many aspects both to procurement and corruption that there will never be one "best" method to resolve corruption. But there are some widely accepted principles to address corruption in public procurement, and the Asian Development Bank (ADB) has used some of these to address fraud and corruption that is perceived, and certainly exists to some immeasurable degree, in its financed projects. These examples illustrate ways in which any institution can understand the environment and establish an appropriate procurement controls; assess existing procurement system controls and risks; strengthen weak procurement accounting and control systems; and share knowledge.

Understand the environment

It is not necessary to reinvent the wheel. Tools to determine widely accepted "standards" already exist. More than a decade ago, in 1993, the United Nations Commission on International Trade Law came up with a model law on procurement of goods and construction. The objectives are to promote competition among suppliers and contractors for the supply of the goods or construction and encourage participation by suppliers and contractors, regardless of nationality, thereby promoting international trade.

Data from diagnostic assessments can establish evidence about corruption in a particular environment, and one only has to search the Internet for numerous sources of such information. Understanding the root causes of the corruption problem can help mobilise people in all sectors of society to be more concerned and turn their words into deeds. But most importantly it can outline needs for specific controls in a public procurement system, transforming what could be outrage with corruption into practical and positive solutions to the problem.

Knowing the specific needs of a particular environment is—or at least should be—important to ADB staff. The types of fraud and corruption that may occur in a particular public procurement process may vary depending on the environment. ADB's anticorruption guidelines and staff instructions obligate ADB staff to consider the levels and risks of fraud and corruption in ADB's lending operations. Staff are expected to design individual projects, as well as monitor and supervise them, paying careful attention to the risk of fraud or corruption within the project.

One of ADB's resident missions is in an environment widely perceived to be very corrupt. Recognizing its environment, the resident mission implemented controls to carefully review all procurement documents and withdrawal applications, and verify certain information prior to ADB's approving such documents. Such activity may include contacting bidders, banks, and other parties to verify the authenticity of information and documents directly or indirectly submitted to ADB. ADB considers those procedures—the screening, review, and verification conducted by resident mission staff specifically assigned to that task—to be a part of normal processing, not an investigation. These processing controls have been effective at detecting fraudulent activity and corruption, and have resulted in numerous cases investigated by the Anticorruption Unit.

Assess procurement system controls and risks

Once a baseline is determined, the next step is to see how closely a specific programme meets that standard. The objective of this task is to comprehensively review

current processes and operations in terms of system, output and personnel, which may affect the overall effectiveness of the public procurement system. Under ADB's Anticorruption Policy, the Anticorruption Unit conducts audits of project procurement-related activity to help detect and prevent fraud and corruption.

The Anticorruption Unit applied a systematic approach to such an assessment of one of its financed projects in South Asia. Through a series of questions extracted from various international standards and codes of practice, ADB assessed the key operational processes of the executing agency for the project. This was more than an assessment of just the procurement tasks. The comprehensive assessment included review of:

- Organisational management, to evaluate the system in place, looking at the mission and controls.
- Transparency and accountability, to evaluate the overall ethical performance in place, considering the prevailing legal arrangements, and existence (or absence) of written procedures governing ethical behaviour and their prevailing application throughout the procurement process.
- Procurement cycle management, to evaluate the overall procurement tasks, including written procedures governing the correct application of procurement laws and rules.

Throughout the evaluation, consideration was given to processes for improvement, and availability and traceability of information—some basic expectations of any effective procurement accounting and control system. Appendix 1 provides a case study of this project procurement-related audit.

Strengthen procurement accounting

ADB found problems of corrupt and collusive practices in one of its funded projects in Southeast Asia. ADB conducted a comprehensive review to strengthen the executing agency's capacity to prevent fraud and corruption in procurement and disbursements on ADB-funded projects and to improve its decision-making procedures and management controls for such projects in a decentralised environment. A result was that ADB and the borrower agreed on specific actions to address some of the problems that led to the corruption. The expected benefits of implementing the agreed upon actions are:

- Improved project implementation arrangements.
- Increased efficiency of project administration.
- Well-defined responsibilities and clear accountability of organisations and individuals involved in project implementation.
- Strengthened implementation monitoring and improved reporting and control mechanisms including audit.
- A transparent business environment allowing fair competition among bidders.
- Participation by project beneficiaries; and clearly defined liabilities for and enforceable sanctions against corrupt and fraudulent practices.

ADB is also applying these actions to other projects it finances executed by that agency.

Share knowledge

Electronic Government Procurement (e-GP) solutions have been proven to produce transparency and significant savings for those countries able to implement them successfully. As a tool in the fight against corruption, the promotion of integration and the stimulation of greater productivity not only at government level, but also in small and medium enterprises, e-GP can be very effective.

At the beginning of 2003, an e-GP working group was created under the Multilateral Development Banks (MDBs) Procurement Harmonization Process. Since then, the Asian Development Bank, the Inter-American Development Bank, and the World Bank have achieved a very high degree of harmonisation in their approach to providing technical advice and support to their member countries in developing their e-GP strategies and solutions.

ADB contributes to a collective Internet-based resource tool at www.mdb-egp.org/data/default.asp, which serves as a single entry point to all the information developed and all the tools created under the e-GP Working Group. This tool can help others plan a strategy and achieve the benefits that e-GP puts at hand.

Annex 25.A.

South Asia Project Procurement-Related Audit

I. Introduction

The ADB Anticorruption Unit (OAGA) conducted a project procurement-related audit of a project financed by an ADB loan approved in 1998 and effective the following year. The project was designed to improve primary roads and bridges of the developing member country. ADB financed more than 60% of the costs of the project. OAGA engaged a firm with expertise in procurement assessments, and participated in the team conducting the audit, which was conducted from April to June 2003.

II. Objectives

The audit was intended to:

- Identify weaknesses in procurement for civil works, project management, project supervision, quality control and recommended appropriate charges in the practices.
- Monitor and report on project compliance with ADB procurement and financial management policies and control structures in the areas examined by this audit.
- Gather and analyse data to assist in documenting and substantiating any fraudulent and corrupt practices as defined by ADB in the executing agency (EA).

III. Scope and Methodology

A. Risk Profiling of EA

The objective of Risk Profiling was to comprehensively review the EA's current processes and operations in terms of system, output and personnel, which may affect the overall effectiveness of ADB's operations with the developing member country.

The Risk Profiling was applied through a self-assessment exercise rather than a strict external audit. It was undertaken through a series of questions assessing the key operational processes. The engaged firm extracted these questions from a series of International Standards and Codes of Practices addressing three key themes.

THEME	CRITERIA
A. Institution's management – Evaluation of the system in place	• Mission of EA • Control of flows (quantity, finances & schedules) • Continuous improvement system • Traceability of information
B. Transparency and Accountability – Evaluation of the overall ethical performance of the EA	• Prevailing legal arrangements • Existence (or absence) of written procedures governing ethical behaviour and their prevailing application throughout the procurement process • Continuous improvement system • Traceability of information
C. Procurement Cycle Management – Evaluation of the overall performance of the EA	• Steps in the procurement cycle • Existence (or absence) of written procedures governing the correct application of lenders' guidelines • Continuous improvement system • Traceability of information

B. Selection and Sampling of Civil Works Contracts

The audit identified six civil works contracts for scrutiny using the following criteria in selecting the samples:

- Cost per kilometre-the most and least costly are to be selected.
- Award timeliness by contract amount-the most and least debated contracts are to be selected, at the post-award stage.
- Amount disbursed per day since contract award-the most and least effective.
- Amount disbursed as a percentage of contract value-the highest and lowest relative disbursement made to date.
- Balancing contracts awarded based on international versus local competitive bidding (international competition is required based on ADB's guidelines depending on the value of the contract).

C. Review of Procurement Processes

The procurement review of the contracts selected consisted in a detailed examination of the ADB Guidelines and the Loan Agreement so as to identify a series of audit criteria. The following criteria, which covered each step in the procurement process, were used in the audit of the six selected contracts:

- Archiving
- Prequalification
- Bid documents
- Opening of bids
- Evaluation/contract award
- Contract
- Execution and physical inspection
- Payments
- Disbursements
- Borrower supervision
- ADB supervision.

D. Physical Verification

The third component of the audit consisted in visual and documentary checks of works in progress against the monthly reports of the Supervision Engineer and the project progress reports. Since all reviewed contracts were still under implementation, no overall contract performance was assessed.

IV. Findings and Recommendations

A. EA Overall Performance Profile

The Risk Profiling of the EA, which consisted of 116 questions given to key decision makers of the EA, concluded that there were no major discrepancies among the three themes in the survey. The results were further broken down to four quality assurance steps: "planning," "doing," "checking" and "acting." The audit indicated that the EA did relatively well in the planning and doing stages.

The audit recommended 46 detailed actions of various significance to improve the performance of the EA, and suggested that once the corrective actions have been launched, the EA might wish to update the Risk Profile to measure their progress against the current benchmark.

B. Compliance Review of the Selected Contracts

The audit found that the process and criteria for pre-qualification were not set up correctly in the beginning of the project. The pre-qualification documents indicated that bidders in Local Competitive bidding (LCB) could qualify for one or more of the five foreseen contracts. However, after evaluation, the EA realized that local bidders could not qualify for more than one contract because of the limited capacity, while the foreign

bidders could qualify for all five contracts. Awarding five contracts to foreign bidders would defeat one of the project's indirect objectives of developing the capacity and knowledge of the local civil work contractors. Exacerbating that situation was that ADB encouraged packaging LCB contracts into a single large package consisting of several contracts to get discounts. The resulting greater value of the packaged contracts attracts bids from greater number of foreign companies, which diminishes an objective to enhance local contractors' capacity.

In the prequalification of one of the contracts, the audit noted that the criteria "completion on time" of the three most recently completed road works contracts and "satisfactory progress" on the three most recent contracts (including ongoing ones) were added. Due to the merit point system, a company could still pre-qualify while they had problems in previous contracts since " completion and progress" together only counted for 25 out of 100 points. At the same time, because of adding these supplementary criteria, scores for other criteria (experience as main contractor and number of contracts) were reduced.

The audit found the Technical and Financial Evaluation Committee (TFEC) presents the final results without the evaluation details. The EA doesn't seem to have a standard evaluation form or template for every member of the evaluation committee to follow. It is assessed that pre-qualification evaluation results lacked transparency, not by purpose, but simply because of the weak preparation of evaluation criteria and their rating system.

The audit found ADB guidelines were not always followed; yet ADB still issued its concurrence. The audit also found one contractor that later changed its name was pre-qualified despite making a false statement of experience. (The EA had informed ADB of the misrepresentation.)

The audit recommended that the pre-qualification criteria and rating systems should be changed and improved for better screening and identification bidders, as well as for avoiding lengthy exchanges with ADB prior to ADB's no objection.

C. Time Effectiveness

The audit found that all contracts took an overall average of 1166 days or 3.2 years to be awarded. Within this time span, ADB took an average 199 days for LCB contracts and 257 days for ICB contracts to issue its concurrence to the EA's decisions. In addition, delays occurred in the preparation stage and in particular between pre-qualification and preparation of bidding documents.

ADB should assess any particular problems with timeliness and find ways to minimize delays and improved the overall process. The audit recommended a wider risk management approach on a portfolio basis, to enable ADB to early identify potential risks in projects.

D. Execution and Follow-up

Contractors presented their construction schedule for the execution of the works in bar chart diagrams. A critical path method (CPM) diagram would be more appropriate since a bar chart does not identify the critical items in a schedule and the different bars are not linked to each other. This means that a delay in one part of the works may lead to the automatic delay of other activities without showing in the progress report.

The audit recommended the use of CPM method as tool to estimate resources both in the pre-tendering stage as well as during execution.

E. Borrower's Management and Supervision

The audit found no written procedures for filing. While the project staff knew its way around the files and was very dedicated, the system could become difficult to manage if the few key people changed assignments.

No third-party verification was done to validate the claims of the contractors. The contractors are paid based on the certificate issued by the Engineer of the EA for value of work done, materials on site, value of approved variations and extras.

The audit recommended that the ADB establish and recommend a simple and standardized filing system for its loans within Borrowers' administration. The audit also recommended using third party in verifying claims of contractors for amounts of work done, but in a way that it will not delay the process.

V. Conclusions

The audit provided feedback to the overall process of interaction between ADB and the borrowing agency from pre-qualification to award of contract. The audit found no major deviations from ADB guidelines.

The EA should be able to improve its performance by implementing the recommendations in the audit report. ADB can help by improving its own actions to provide timely supervision and feedback during the bidding process.

Part III.B

Compliance with Anti-Corruption Laws through Access to Public Procurement: Sanctioning or Voluntary Self-Regulation?

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Chapter 27	Regulating Access to Public Procurement: Issues for Consideration Nicola Ehlermann-Cache OECD Anti-Corruption Division
Chapter 28	The World Bank's Sanctions Process Françoise Bentchikou Chief Counsel, Procurement and Consultant Services, The World Bank
Chapter 29	Compliance with Anti-Corruption Laws through Access to Public Procurement: The Asian Development Bank Experience A. Michael Stevens Principal Audit Specialist (Financial Investigator), Anticorruption Unit, Office of the Auditor General, Asian Development Bank
Chapter 30	Exclusion of Tenderers in the European Union – The Only Way Forward against Procurement Fraud? Simone White European Anti-Fraud Office (OLAF), European Commission
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Chapter 26

Main Findings on the Forum Workshop on "Compliance with Anti-Corruption Laws through Access to Public Procurement: Sanctioning or Voluntary Self-Regulation"

by

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This workshop focused on controlling access to public procurement as a means of preventing corruption and as a form of sanction in cases where corruption in the procurement process has occurred. Workshop discussions and the papers prepared for the workshop, included later in this chapter, illustrated that provisions and practices regulating access to public tendering differ greatly between countries and among international institutions. Participants raised several questions and issues that varied significantly according to the context of the tender procedure and the nature of the tendering authority. Priorities and considerations can depend on whether the bidding procedure involves international organisations, multilateral development banks, international financial institutions, national agencies or communities at a sub-national level and whether tendering authorities are subject to domestic or international law, among other factors. Obviously, at the national level, the issue calls for a detailed analysis of countries legislation in relation to both the definition and sanction of corruption as well as political party financing. Participants also discussed the implementation of voluntary self-regulation measures and how these contribute to preventing corruption.

Prevention

Prevention and sanction are closely linked. Such is the case in the context of the French legal system; for example, once a code of good conduct is established, and in the case of a violation of the code, it can be considered that the intentional element of the offence is constituted.

Participants briefly discussed the importance of effective prevention. Indeed, it is crucial to fighting corruption as detection, prosecution and sanction of corruption after the fact are difficult and almost always involve long, complex proceedings.

Some preventive mechanisms were described during the session and in the papers prepared for the workshop. One such mechanism is *whitelisting*, an incentive approach where companies eligible to participate in tendering are pre-selected based on specific anti-corruption criteria (*e.g.* compliance with anti-bribery laws, no past involvement in corruption cases, implementation of codes of good conduct). Another such mechanism is an *integrity pact* – a form of voluntary self-regulation where procurement officials and the bidders mutually commit to refrain from and prevent corruption and agree to sanctions in case of violation. The Korean Public Procurement Service described in detail an integrity pact implemented in 2001, and reported that it has raised awareness of the need for integrity among companies and public officials, reduced corruption in government procurement and encouraged better implementation of contracts. While integrity pacts may have little impact in strict legal terms, they are reported as being a useful tool to inform systematically both officials and bidders of what constitutes a corrupt act and the consequences of committing such an act.

Yet another approach for the prevention of corruption raised during the workshop is a *sector agreement*, whereby companies in a particular business sector voluntarily commit to anti-corruption principles in carrying out their activities. Existing agreements include *Business Principles for Countering Bribery*, developed by Transparency International and Social Accountability International, or *Business Principles for Countering Bribery in the Engineering and Construction Industry*, adopted by several leading international firms at the 2004 meeting of the World Economic Forum. These and other preventive measures are described in workshop papers.

Self-regulatory codes can be developed in the context of the business sector, and may aim to influence business behaviour for the benefit of the firm itself (*e.g.* by enhancing the company's reputation or by decreasing the risk of sanctions). Codes can also serve to raise awareness among employees and the general public about a company's commitment to fighting corruption and how it works to meet this commitment. Codes may also be developed by state authorities. These codes typically aim at fostering integrity in public service and formalising expected standards of conduct for public officials. Participants agreed that although preventive tools have a positive impact in the fight against corruption, they are insufficient to eradicate corruption and that sanctions were important both as a deterrent and as a penalty.

Sanctions

The majority of the discussion in workshop four focused on sanction of corruption in public procurement. Participants raised several important questions:

- What actions should be sanctioned? And who should be sanctioned (*e.g.* individuals, companies, senior managers, junior employees, subsidiaries, public entities, accomplices)?
- What kinds of sanction procedures are most appropriate (*e.g.* administrative, civil, penal)?
- What types of sanctions should apply to fraud and corruption in public procurement (*e.g.* fines, prison sentences, confiscation, denial of access to tendering, mandatory publicity of offences)?
- Which sanctions are most effective and are sanctions applicable to corruption in both national and international public procurement?
- Should plea-bargaining, appeals or other types of recourse be considered? Under what circumstances?

These and other pertinent questions raised in the workshop testify to participants' keen interest in the use of sanctions and the potential impact of sanctions as a deterrent to corruption. They also demonstrate, however, that existing models of sanction vary greatly in approach, scope and effectiveness and that participants considered that much work was required to achieve a clear understanding of how best to design and implement sanctions.

Participants discussed a range of sanction procedures. In the case of international organisations, there are administrative procedures. In national contexts, procedures can be civil, penal or administrative. In considering various sanction procedures, it is important to know what results are being sought. It became clear through the discussions that procedures should be efficient, expeditious, clear and transparent. They should also be formulated to avert attempts to exploit procedures to serve contrary interests – to stall a procurement process or as a means to make ungrounded accusations of corruption against competitors, for example. Situations where victims of corruption are reticent to come forward – either because they perceive the process to be too slow or inefficient or that using procedures might entail a risk to future business potential or to themselves – must also be avoided when creating and implementing sanction procedures. Procedure, in terms of both its nature and its ultimate goals, is a crucial question when considering sanctions.

Denial of access to bidders in public procurement, also referred to as debarment – the exclusion of a contractor who is or has been involved in corruption from competition for contracts – was the major focus of the participants' work around sanctions. Some considered debarment to be among the most effective sanctions and a dissuasive tool. A firm or an individual whose name figures on a list of debarred companies, a blacklist, would be less inclined to commit the same acts again. In any case, the blacklisted entity would be excluded from tendering for some period of time and to some extent – for example, across a sector of activity, within a country or other geographical region, or with respects to certain public entities.

An issues paper prepared for this workshop (see Chapter 27) sets out major issues related to debarment from public tendering, particularly in the context of the global fight against corruption, as a means of prevention, deterrence and sanction. Exclusion from bidding may be governed directly by public procurement laws or in the penal code, or based on regulations and guidelines. Usually, formal exclusion procedures do not exist, and exclusion is at the discretion of the competent judicial or administrative authority.

The discussion on debarment, again, raised several important questions: how is information about debarred entities managed? how are lists of debarred companies – blacklists – established? who should manage them? who should have access to the information: the general public, companies, one or several national governments, international organisations? How is information shared and circulated: internally within a country or organisation? among several countries? among international organisations? Can blacklists be shared without risk of prejudice to those listed? Are procedures among different countries and organisations comparable? The questions and challenges of debarment are myriad. Debarment procedures in Italy and in Germany and issues specific to debarment in relation to the recent European Public Procurement Directive, are described in detail in workshop papers.

International Financial Institutions have differing approaches to debarment and managing information related to debarment. Françoise Bentchikou, Chief Counsel, Procurement and Consultant Services, at the World Bank elaborated extensively on her institution's experience with procurement and with debarment, the lessons taken from this experience and the extensive reflection behind the reforms currently being undertaken to improve procedures to sanction corruption in World Bank-funded procurement. In papers prepared for the workshop, approaches of both the World Bank and the Asian Development Bank to sanction processes and the complexities they have encountered in implementing sanction policies are described in detail. The Asian Development Bank, for example, does not consider that its blacklist is public information. The World Bank publishes its blacklist on its Web site. It can be argued that publicising blacklists is a simple, quick means to inform a borrower of ineligible companies. Counter-arguments may include administrative reasons or the lack of a clear, consistent understanding of the terms "fraud" or "corruption" across countries, creating a range of possible interpretation of what it means to appear on a blacklist. It has also been observed that while blacklists are not necessarily published, many in the industry circles come to know which companies have been blacklisted.

The workshop participants' reflection led to some proposals. Before considering common rules, it may be useful to establish an observatory in order to study and compare practices and difficulties across countries, regions and organisations. It may also be beneficial to establish common criteria and define and collect comparable statistics, to track progress and identify ways to coordinate and improve efforts in the fight against

corruption in public procurement. Further questions were raised as to the most appropriate context for such cooperation: could this work be carried out in an international framework? Would the OECD be a suitable forum for such coordinated efforts? New international regulations that seek to level the playing field in global business transactions have emerged, for example, in the context of the European Union. In what ways do these regulations necessitate further reflection on how to formulate and implement a coherent, global approach?

Chapter 27

Regulating Access to Public Procurement: Issues for Consideration

by

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The views expressed herein are those of the author; they may not reflect the views or policies of the OECD.

Introduction

Countries generally aim at achieving a number of goals through public procurement. Clearly, a primary goal is to obtain goods or services at the best possible price. Further objectives include, *inter alia*, efficiency and probity in the procurement process and fair and equal treatment of providers. Other primary goals may be to support industrial, social and environmental policies, to name a few.

Public procurement lies at the crossroad of the public and the private sectors. Consequently, it provides a multitude of opportunities for corruption, *i.e.*, for making government decisions based on interests or objectives which are not recognised as 'legitimate' in the procurement process.

The primary goals of public procurement are generally reflected in the legal provisions promulgated by States to control the award of contracts. Increasingly, countries must ensure that officials involved in the procurement process apply domestic legislation in a consistent manner and that the legal framework for procurement and its practical application complies with their country's international commitments.

Legal obligations negotiated in regional or international fora are manifold. Some of the international provisions aim at fighting corruption and state capture[1] and foresee, as a sanction for corruption, the temporary or permanent denial of access (debarment) from public procurement.

This note outlines different issues related to debarment from public tendering, particularly those that arise in a period when the fight against corruption is being internationalised. This note does not address corruption-related sanctions imposed on the procuring entity or the public agent.[2] Nor does it aim to identify the most frequent or the most desirable practices – if any. (A glossary of terms used in this note is annexed).

Context and Objective

Denial of access to public procurement is understood to be a means to prevent, deter and sanction corruption. Until recently, implementation and enforcement of domestic debarment provisions by countries was rather limited. It was commonly viewed that mainly International Financial Institutions (IFIs) were implementing anti-corruption policies and practices that could eventually lead to the debarment of individuals or firms after determining that they had been involved in corruption related to a project financed by such institution (see Annex 27.B. for current World Bank provisions).

However, in recent months, the media has reported that some countries have begun to apply non-criminal provisions to fight corruption. Media reports indicate that several companies shall be debarred from public tenders in various countries as a result of bribery charges. Furthermore, provisions negotiated in the international arena provide a basis for reinforcing this practice (see boxes 27.1. and 27.2.). Reportedly, several IFIs are considering amending their internal provisions to increase the effectiveness of their debarment policies. In light of these more recent developments, the question arises whether debarment could become more frequently applied in connection with corruption.

Box 27.1. OECD Instruments to Fight Bribery in International Business Transactions: The Public Procurement Provisions

Parties to the *Convention on Combating Bribery of Foreign Pubic Officials in International Business Transactions* have pledged to criminalise the "giving" or "supply" of bribes to foreign public officials in order to obtain or retain business in international commercial transactions. In addition, they have committed to implementing and enforcing non-criminal provisions included in the *Revised Recommendation on Combating Bribery in International Business Transactions*. Both the Convention and the Revised Recommendation contain provisions relating to public procurement.

The Revised Recommendation addresses various public procurement related aspects indispensable to winning the battle against corruption. Good public management and governance through improved transparency and enhanced bribery prevention are advocated. Exclusion from public procurement as a sanction for corrupt behaviour is also promoted. *(See Annex 27.C. for the public procurement related Sections of the Revised Recommendation.)*

Section VI paragraph i) supports the World Trade Organisation's (WTO) effort to pursue an agreement on transparency. This provision was aimed at ensuring that actions be taken to fight the demand for bribes in all WTO counties. Indeed, action aimed at reducing the demand for bribes is complementary to and reinforces the efforts by Parties of the Convention to eliminating the supply of bribes. While the General Transparency Agreement remains in force for the adhering countries, the WTO decided not to engage in further negotiations regarding transparency in public procurement for the time being.

A further provision in support of good management and governance is included in Section VI paragraph iii), which recommends the safeguard of foreign aid assistance, notably through the adoption of clear anti-corruption clauses in bilateral aid-funded procurement.

Finally, effective sanctioning deters corruption. Section VI paragraph ii) is most relevant to the discussion of this paper on denial of access to public procurement. It recommends:

*(ii) Member countries' laws and regulations should permit authorities to suspend from competition for public contracts enterprises determined to have bribed foreign public officials in contravention of that Member's national laws and, to the extent a Member applies procurement sanctions to enterprises that are determined to have bribed domestic public officials, such sanctions should be applied equally in case of bribery of foreign public officials.**

Article 3 of the Convention (Sanctions) states that criminal sanctions shall be imposed on natural persons. While countries were convinced that sanctioning legal persons for foreign bribery was particularly important when negotiating the terms of the Convention, they did not stipulate that sanctions be of a criminal nature. Consequently, Article 2 asks countries to introduce the "responsibility of legal persons" while Article 3 (2) states that non-criminal sanctions against a corporation are also acceptable, provided they include monetary sanctions and are "effective, proportionate and dissuasive". In Commentary 24 to Article 3, an explicit reference is made to the "temporary or permanent disqualification from participation in public procurement".

* "Member countries' systems for applying sanctions for bribery of domestic officials differ as to whether the determination of bribery is based on criminal conviction, indictment or administrative procedure, but in all cases it is based on substantial evidence."

Box 27.2. Excerpts of Directive 2004/18/EC on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts

Section 2
Criteria for qualitative selection
Article 45

Personal situation of the candidate or tenderer

1. Any candidate or tenderer who has been the subject of a conviction by final judgment of which the contracting authority is aware for one or more of the reasons listed below shall be excluded from participation in a public contract: *

(a) participation in a criminal organisation, as defined in Article 2(1) of Council Joint Action 98/733/JHA;

(b) corruption, as defined in Article 3 of the Council Act of 26 May 1997 and Article 3(1) of Council Joint Action 98/742/JHA (3) respectively;

(c) fraud within the meaning of Article 1 of the Convention relating to the protection of the financial interests of the European Communities;

(d) money laundering, as defined in Article 1 of Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering.

Member States shall specify, in accordance with their national law and having regard for Community law, the implementing conditions for this paragraph.

They may provide for a derogation from the requirement referred to in the first subparagraph for overriding requirements in the general interest.

For the purposes of this paragraph, the contracting authorities shall, where appropriate, ask candidates or tenderers to supply the documents referred to in paragraph 3 and may, where they have doubts concerning the personal situation of such candidates or tenderers, also apply to the competent authorities to obtain any information they consider necessary on the personal situation of the candidates or tenderers concerned. Where the information concerns a candidate or tenderer established in a State other than that of the contracting authority, the contracting authority may seek the cooperation of the competent authorities. Having regard for the national laws of the Member State where the candidates or tenderers are established, such requests shall relate to legal and/or natural persons, including, if appropriate, company directors and any person having powers of representation, decision or control in respect of the candidate or tenderer.

* Underlining was done by the author of this article.

To date, relatively little is known about the overall debarment context, its legal framework or countries' implementation and enforcement policies and practices. Nonetheless, it appears, based notably on the OECD's monitoring of the laws and enforcement of the anti-corruption provisions of Parties to the 1997 Convention on Combating Bribery of Foreign Public Officials in International Business Transactions as well as on complementary research, that the legal basis for debarment varies considerably and shows a wide diversity of legal approaches.

If debarment from public procurement is a strong and effective means to deter and sanction corruption, it also raises a number of concerns. In particular, considering the divergent legal provisions and the differences in approach, a central question is whether

the current context provides a level playing field between competitors. In other words, does it ensure equal treatment of all participants in the procurement process?

Against this background, and in light of more recent developments, a better understanding of the existing provisions on debarment is needed as well as knowledge about their implementation and enforcement.

Box 27.3. Discussion questions on debarment and voluntary self-regulation

Reflection and discussion on these and other questions and experiences may help gain a better understanding of issues surrounding debarment and other possible approaches to prevent, deter and sanction corruption.

To what extent and under what conditions can debarment be considered an effective means to deter and sanction corruption?

What factors or considerations make debarment difficult to impose or ineffective?

What requirements need to be fulfilled in order to strengthen the central notions of fairness and a level playing field with a view to possibly contributing to the formulation of more uniform and effective global standard for debarment from public procurement for corrupt practices?

What should be considered in reflecting upon the enforcement of a debarment provision in the context of corruption offences relating to domestic or international business transactions?

What possible alternative or complementary approaches exist to ensure the effective prevention, detection and sanction of corruption in public procurement?

Is voluntary self-regulation effective in the context of public procurement?

Are whitelisting and integrity pacts effective tools? If so, to what extent they may be considered alternatives to debarment?

Debarment from public procurement

National provisions on denial of access to tender

Well-developed systems of public procurement generally regulate access of bidders to public contracting. The provisions relating to debarment, exclusion or denial of access to a bidding opportunity may be covered by public procurement laws, the penal code or regulations.

The reasons for denial of access to tender procedures are manifold: corruption is often one of them as may be other crimes, irregularities or the lack of technical or financial capacity. Provisions regulating access to public procurement vary widely among countries, depending notably on the underlying purpose(s) of public procurement. Debarment, exclusion, or denial of access may be considered as a deterrent to corruption, as a penalty, or as a disincentive for dishonest activity in future contracts.

Consequently, and depending on the underlying purpose pursued by national authorities, different types of actions are foreseen:

- Exclusion from a particular tender; this may occur when bidders have engaged in a prohibited practice in relation to the procurement in question.

- Disqualification (debarment) of businesses that have been involved in corrupt, fraudulent or other improper conduct in connection with government contracts, applicable to future procurement.
- Debarment of businesses involved in past criminal activities, even when this activity has not been connected with government procurement.
- Termination of an existing contract where the contract award was tainted by breach of the anti-corruption rules, or if the contractor has been engaged in criminal or unethical activity unrelated to the contract.

Basis for exclusion

Exclusion may be based on different procedural outcomes and take effect in various ways, such as:

- Disqualification for non-compliance by the tenderer with certain provisions or rules, including integrity rules.
- Disqualification resulting from denunciation and/or a suspicion of corruption.
- Debarment following an indictment (*i.e.*, suspension while investigation of the offence is ongoing).
- Debarments based on a criminal conviction.

It is often argued that debarment based on a criminal conviction may be difficult to impose, due to the high standards of proof and the difficulty of bringing a prosecution. This raises the question whether states should be able to exclude individuals and firms through an administrative procedure in lieu of a court hearing, provided there is substantial evidence of the alleged misconduct.[3]

Duration of Exclusion

Debarment can be imposed at different times and for different periods:

- Debarment may affect an existing contractual relationship.
- Debarment may be imposed beyond any one transaction, in which case it may be definite or indefinite. In case of temporary exclusion, a minimum or maximum period of debarment may be fixed. Different procedures for reinstatement may also be envisaged (see section below on "Conditions for Reinstatement").

A question arises when debarment is based on a conviction: at what point in time does disqualification take effect in respect of a conviction (*i.e.*, before, during, after)?

Applicability of sanctions

National provisions may regulate the debarment procedure to apply to:

- Natural persons (*e.g.*, the firm's officers or directors).
- Legal persons as an administrative sanction or a criminal sanction (if the domestic law provides for "corporate criminal responsibility").
- In the case of legal persons, debarment may apply to:

- The legal entity concerned.
- All associated with the tender (*e.g.*, sub-contractors, associates, agents).
- All subsidiaries or all group companies (depending on the different methods of consolidation).

Not all countries provide in their domestic law for "corporate criminal responsibility". In such case, the question is whether a level playing field can be achieved through civil/administrative procedures and sanctions and whether the purpose and objectives of an administrative procedure equate those of a criminal conviction.

Exclusion may apply only to certain tenders by some purchasing authority(ies). But debarment may also apply to all public tenders. Furthermore, debarment from public tendering may have an effect on dealings with other public entities (*e.g.*, export credit agencies or official development aid agencies) and result in ineligibility for support.

Obviously, the economic consequences of different sanctions are not equal. Further, it may be questioned whether and how associated risks are evaluated, including the risk of bankruptcy.

Implementing Procedure(s)

Who makes the decision to debar a tenderer is central. The decision may be with the procuring entity which may have discretion to debar. But debarment may be subject to approval by a higher authority or possibly a separate entity. In certain cases, the decision lies with the judiciary.

It would appear that the rules applicable to tendering authorities are diverse and that the scope of their authority regarding (possible) bribery and other corrupt activities varies greatly:

- Tendering authorities may not be empowered to investigate tenderers or may lack experts that could investigate misconduct.
- Where tendering authorities do have authority to investigate, there is no automatic examination of the reliability of a tenderer; instead, reliability is investigated ex officio only in case of doubt.
- Some tendering authorities have an obligation to investigate and monitor companies' integrity and thus have authority to debar dishonest bidders. In such a case, it is important to assess whether officials are sufficiently aware of the manifestations of corruption in order to be able to detect them (see also Part III. A. Identifying risks in the bidding process).

A lack of resources during the course of the full procurement process coupled with increased risks, including penal liability, may cause tendering authorities to be reluctant to check the veracity of declarations of the bidders. Indeed, exclusion may expose tendering authorities to risk insofar as it may lead to damage claims by tenderers.

When debarment is pronounced as a criminal sanction, who is responsible for its enforcement? Here again, different situations exist, and the question arises: Should the tendering authorities be responsible for checking the compliance of tenderers against a set of grounds for exclusion?

If there is no "obligation" to enforce debarment and/or in the absence of a clear control system, how is the sanction enforced?

Other questions relate to whether contractors can circumvent debarment and continue to bid on government contracts with a different corporate identity, with different officers lacking criminal records or as subcontractors. The question of circumvention may also be posed in connection with electronic commerce and e-procurement or do these techniques ensure sufficient screening of bidders?

Access to information on denial of access to public tenders

Debarment implies access by tendering authorities to information concerning bidders. Indeed, if tendering agencies have an obligation to debar, they need to obtain the relevant information in order to enforce the exclusion provision and debar corrupt tenderers.

Should data about bidders be collected and shared systematically between tendering authorities? Should data be centralised with or without blacklisting? Should the sharing of information be organised in a formal or an informal manner? Should consultation of the data be voluntary or mandatory? Should information be based on a system of self-declaration (with or without verification by tendering authorities)? A notable example is the Vendor Information Exchange System (VENDEX) which was introduced by the city of New York to assist officials in determining whether the contractor is, among other things, in (moral) good standing to do business with the city.

In the case of debarment as a criminal sanction, the criminal record would need to be made available by the prosecutorial authorities to tendering authorities. However, this may raise the question of how the exchange of information should be organised: Should it be through regular information channels and existing units or through a central register with a central administrative unit that would ensure data and privacy protection?

Would the register be open for consultation by all national tendering agencies? Would consultation by the tendering authorities of the register be mandatory or voluntary (in the case of doubt by the tendering authority about a bidder)?

What kind of relationship should the tendering authorities have with private actors that provide information such as banks and others facilities (for instance the International Chamber of Commerce Crime Commission)? This question may be particularly relevant in the context of increased outsourcing of public functions (see also "Data Protection" below).

National and transnational application

While it is often stated that sanctions apply in principle to domestic and foreign (natural/legal) persons, it remains to be tested to what extent debarment by the authorities of country X for corrupt practices in country Y trigger exclusion from public tendering in country Y and possibly all countries that are Party to the same regional or international convention.

In an era of free trade and investment when tenderers regularly participate in cross-border bids, it is indeed essential to assess whether it is desirable that debarment take effect in more than one country; furthermore, would it be desirable to have an international exchange of information on debarment? For instance, should Parties to the OECD Anti-bribery Convention be able to access information on excluded tenderers (natural or legal persons) which is available in other countries Party to that Convention?

To answer the preceding question, a determination must be made on whether there is mutual recognition of disqualification leading to exclusions or whether the divergence of procedures and underlying reasons for disqualification preclude such approach.

If there were a central, national register and an exchange of information between states, including for similar offences, would this effectively exclude perpetrators of fraud and corruption offences from tendering procedures in other states?

This question raises a related concern: Who would be in charge of ensuring due diligence by all agents involved in the tendering process?

Tenderers' rights

Debarment raises a number of issues in relation to tenderers' rights when imposed by tendering authorities in the absence of a court decision: Are adequate safeguards in place to protect against malicious denunciation? Who has the burden of proof? In addition, even where there is a court decision, what recourse does an accused/convicted person (legal or natural) have?

How is information gathered by public agencies concerning a natural or legal person? Is information confidential? Is the decision to debar communicated to the persons subject to the decision? Should the right to a hearing be granted in case of debarment and what standard of proof of the misconduct should the agency require? Is a mere balance of probabilities sufficient or must there be a greater degree of certainty such as to exclude reasonable doubt? Should evidence be weighted?

Do legal provisions grant a right of appeal against exclusion and if so, are clear appeal procedure(s) in place? Do guidelines and standards define and set the boundaries with regard to the rights of the appellant? Are appeals on record? How and in what time frame, if at all, should incorrect data on which the exclusion was based be rectified?

In the case of wrongful exclusions, can the victim demand compensation?

Data protection

Debarment may also raise questions related to data-protection laws and human rights laws. Temporary disqualification based on the suspicion of corruption may raise constitutional and human rights issues.

Similar questions concern the exchange of information between state authorities and private or semi-private entities responsible for public purchases (indeed, in some countries many public functions are outsourced).

Conditions for reinstatement

If debarment is temporary, it may be lifted either automatically after a fixed period of time or upon approval by an authority (oversight body). In certain cases, reinstatement is dependant on an approval procedure based on certain conditional measures. How are these conditional measures determined and are they in direct relation to the circumstances surrounding the debarment? Or are they determined in more general terms and dependent, for instance, of the establishment of voluntary codes of ethics and other compliance methods as a pre-requisite for re-qualification in tenders?

In an effort to prevent corruption and/or to obtain reinstatement to participate in public tendering, should companies outwardly address the problem, say, by removing the briber, adopting voluntary compliance tools (*e.g.*, code of conduct etc.) or adopting internal controls?

Using Access to Procurement as an Incentive against Corrupt Behaviour

The use of access to procurement as an incentive – the so-called "white list" approach – requires companies desiring to bid for public procurement contracts to certify that they comply with all anti-bribery laws and that they have internal management and accounting practices that ensure compliance with these laws.

Self-certification can be strengthened or replaced with third-party certification by auditors or other independent entities that it has adopted adequate internal management and accounting practices and controls. Contracts may also include provisions for liquidated damages, *i.e.* a certain percentage of the amount of the contract is withheld from payments and forfeited if corruption occurs.

Although these approaches have strong proponents, it may be useful to consider how governments can ensure that such certification is not a “shield” for corrupt behaviour.

Some may question whether self-regulation may negatively impact the enforcement of “criminal corporate liability” where corporate compliance programs relieve companies from criminal liability.

Self-certification has further been questioned because it may be discriminatory and may discourage small firms from participation in the bidding process.

Public Procurement authorities and agencies may also adopt Integrity Pacts for Suppliers under which the principal and the bidders pledge not to engage in corruption. Integrity Pacts also provide for the cancellation of the contract where a supplier is found to have bribed an official(s).

Notes

1 The use of bribery to leverage control over legislation, regulation, policy and contract award decisions.

2 In other words, this note only addresses active corruption. In most countries, the procuring entity violating the rules, as well as the public official(s) who has (have) taken the bribe(s) would be sanctioned. The sanctions may be of a criminal, disciplinary or administrative nature.

3 The latter may often be the case for irregularities but not for criminal offences.

Annex 27.A.

Glossary of Selected Public Procurement Terms

Note: These definitions are not intended to be legal definitions.

Blacklist A list of natural or legal persons with whom no dealings are to be had by those circulated with the list.

Denial of Access (Debarment, Disqualification or Exclusion). Exclusion or ineligibility of a contractor from taking part in the process of competing for government or multilateral agency contracts for a definite or indefinite period of time if, after inquiry and examination, the contractor is adjudged to have been involved or is involved in the use of corruption to secure past or current projects with the government, agency or agencies that operate similar policies which are considered recognised as also applicable to the debarring agency.

Debarment (see Denial of Access).

Disqualification (see Denial of Access).

E-procurement Procurement process that uses the Internet as the main mechanism to facilitate or conclude transactions.

Exclusion (see Denial of Access).

Integrity Clause A contractual provision in a government procurement that describes the ethical limits on certain activities and conduct of the contractor and the government.

Integrity Pact An agreement between a government or government department and all bidders for a public sector contract that neither side will pay, offer, demand or accept bribes, or collude with competitors to obtain the contract or while carrying it out. It also stipulates that bidders will disclose all commissions and similar expenses paid by them to anybody in connection with the contract and that sanctions will apply when violations occur. Sanctions range from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to blacklisting for future contracts on the side of the bidders, and criminal or disciplinary action against employees of the government.

Procurement The acquisition, by contract, of supplies or services, by and for the use of a government through purchase or lease.

Rehabilitation (see Reinstatement)

Reinstatement (Rehabilitation) Re-qualification as eligible for participating in the public procurement process, which may require the satisfaction of certain conditions.

Suspension A temporary exclusion that prevents a firm from competing on government contracts pending the result of an investigation or a legal proceeding.

Tender process The process by which persons or companies provide formal offers for a contract. It can be open, when with the appropriate time a public invitation is made to any one who would like to submit offers; or not-open, this is, a restricted invitation with different degrees of restriction, live an invitation for people or companies with special characteristics to present offers.

Whitelisting An incentive approach which requires companies desiring to bid for public procurement contracts to certify compliance with anti-bribery laws and that they have adequate internal management and accounting practices to ensure compliance.

Voluntary self-regulation Regulating conduct through the use of industry rules and ethical rules rather than through legislation.

Annex 27.B.

International Financial Institutions' Corruption-Related Procurement Guidelines

Many International Financial Institutions (IFIs) have established procurement guidelines that include anti-corruption clauses.

The World Bank's guidelines for instance state that the Bank will:

- "reject a proposal for award if it determines that the bidder recommended for award has, directly or through an agent, engaged in corrupt, fraudulent, collusive, or coercive practices in competing for the contract in question;
- "reject a proposal for award if it determines that the bidder recommended for award has, directly or through an agent, engaged in corrupt, fraudulent, collusive, or coercive practices in competing for the contract in question;
- cancel the portion of the loan allocated to a contract if it determines at any time that representatives of the Borrower or of a beneficiary of the loan engaged in corrupt, fraudulent, collusive, or coercive practices during the procurement or the execution of that contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation;
- sanction a firm or individual, including declaring ineligible, either indefinitely or for a stated period of time, to be awarded a Bank-financed contract if it at any time determines that the firm has, directly or through an agent, engaged in corrupt, fraudulent, collusive, or coercive practices in competing for, or in executing, a Bank financed contract; and
- have the right to require that a provision be included in bidding documents and in contracts financed by a Bank loan, a provision be included requiring bidders, suppliers and contractors to permit the Bank to inspect their accounts and records and other documents relating to the bid submission and contract performance and to have them audited by auditors appointed by the Bank."

The World Bank also has guidelines on the selection and employment of consultants by World Bank borrowers which apply the very same set of sanctions to consultants.

Most IFIs anti-corruption policies and practices are characterised by: (1) internal units devoted to the promotion of anti-corruption practices and the investigation of potential instances of corruption associated with the projects financed by the institution; (2) sanctions for corruption related to the procurement process; and (3) debarment of individuals or firms when it is determined that they have been involved in a corrupt activity in relation to a project being financed by the institution.

Annex 27.C.

Excerpts of the Revised Recommendation on Combating Bribery in International Business Transactions

Article II.

[The Council] RECOMMENDS that each Member country examine the following areas and, in conformity with its jurisdictional and other basic legal principles, take concrete and meaningful steps to meet this goal: …

v) public subsidies, licences, government procurement contracts or other public advantages, so that advantages could be denied as a sanction for bribery in appropriate cases, and in accordance with section VI for procurement contracts and aid procurement; …

Article VI:

[The Council] recommends:

"i) Member countries should support the efforts in the World Trade Organisation to pursue an agreement on transparency in government procurement;

ii) Member countries' laws and regulations should permit authorities to suspend from competition for public contracts enterprises determined to have bribed foreign public officials in contravention of that Member's national laws and, to the extent a Member applies procurement sanctions to enterprises that are determined to have bribed domestic public officials, such sanctions should be applied equally in case of bribery of foreign public officials.[1]

iii) In accordance with the Recommendation of the Development Assistance Committee, Member countries should require anti-corruption provisions in bilateral aid-funded procurement, promote the proper implementation of anti-corruption provisions in international development institutions, and work closely with development partners to combat corruption in all development co-operation efforts."[2]

In the future, State Parties to the Convention may update the Revised Recommendation, including Article VI on public procurement.

1. "Member countries' systems for applying sanctions for bribery of domestic officials differ as to whether the determination of bribery is based on criminal conviction, indictment or administrative procedure, but in all cases it is based on substantial evidence."

2. "This paragraph summarises the DAC recommendation, which is addressed to DAC members only, and addresses it to all OECD Members and eventually non-Member countries which adhere to the Recommendation."

Chapter 28

The World Bank's Sanctions Process

by

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The following is a brief summary of the Bank's experience in the sanctioning process from a "best procurement practices" view point. A Board Report on Reform of the World Bank's Sanctions Process is annexed.

Lessons from Past and Current Cases

What have we observed lately that could help prevent fraud and corruption in public procurement--some of these points constitute what are commonly referred to as "red flags":

- A specific public procurement agency's unusual pattern of action, *i.e.* either applying rules in a very strict manner when it usually flexible, or vice-versa. (note: while unusual procurement patterns may be explained by corruption, an abnormal procurement pattern could also be explained by plain misunderstanding of procurement rules or project considerations: for example, emphasis on speedy implementation with ill-considered shortcuts).
- Unresolved, justified bid protests.
- Payment of fees to local representatives.
- Large Sole-source continuation of existing contracts (in terms of percentage or overall amount).
- Delayed procurement action which makes it practically impossible to review the basis for a procurement decision.
- Pricing of service rendered, specifically with respect to the identification of inputs or outputs appears to be incommensurate with the payments claimed for the same.
- A Government agency is not interested in defending its own/the public's interests.
- High prices for common goods are accepted by the procuring agency.
- There is a totally new or unknown company appearing as supplier or sub-contractor.

Note: If facilitation payments are detected and petty corruption is there, there is probably also widespread corruption in government contracts.

Prevention Measures: Short Term

- One can check prices of common goods on the Internet.
- It is useful to listen to competitors and diligently conduct bid protest reviews (note: it is much easier to detect departures from the applicable procurement procedure when all bid evaluation criteria are quantified tin monetary terms or expressed in the form of a pass/fail screening).
- A more proactive, diligent review of procurement documentation is useful as a screening mechanism, but it has limitations as fraud, which is essentially a unilateral misrepresentation on the part of a bidder, can go undetected.
- Conducting procurement audits, which is not preventive, can help identifying patterns and also creates a deterrent for future irregularities.

- Performance security of the winning bidder could be systematically verified with the issuing bank.
- The procurement method called "shopping" could usefully be contained in narrow circumstances and be subject to a systematic checking of price references on the Internet. Similarly, framework contracts awarded to multiple suppliers should be subject to controls or audits.
- What seems not be a sound procurement decision (*i.e.*, a decision you would have taken yourself if this were your own contract and money) should be challenged. Proactive, diligent review of procurement documentation is useful as a screening mechanism (this has limitations: fraud—which is essentially unilateral, can go undetected).

Prevention Measures: Long Term

- Transparent procurement institutions relying on checks and balances should be set up.
- Open competitive bidding with its four "pillars" of transparency (advertisement, public bid opening, award to lowest evaluated bid on the basis of transparent and objective bid evaluation criteria—no point system, no negotiation) should be the rule.
- Conversely, non-transparent mechanisms such as competitive negotiations, two-envelope system, point system, pre-award negotiations, contract extensions, should be systematically avoided.
- Procuring agencies could usefully increase reliance on controls and he oversight provided by the business community as a whole.
- The results of competition must be advertised in a timely manner (this increases bidders' empowerment, and increases the possibility that bid review mechanisms achieve their objective in a timely fashion).
- Remedies should always include protests against the winning bid and against the choice of procurement procedure (main source of abuse "upstream" in a corrupt environment).
- The user's interest (PTAs, users of medical services) can be enlisted to control the quality of contracts outputs. The main features of the contract (price, time for completion, basic specifications) can be posted on the job site.
- The contract forms have to be transparent and predictable; discretionary provisions such as broadly defined compensatory events must be avoided.
- Audits have to be conducted in a timely manner, making the results public immediately.

Note: When investigations have to be conducted in relation to an ongoing procurement processes, it is extremely difficult, given the time constraints, to combine fairness together with timely procurement decisions. This is specifically true in the case of collusion, where willing to exclude bidders right away, without consideration for due process.

Annex 28.A.

Reform of the World Bank's Sanctions Process

I. Background of the Sanctions Committee: 1998 – 2001

1. The Bank's sanctions process was first formulated in a paper presented to the Executive Directors in July 1996,[1] and was implemented in a January 1998 Operational Memorandum.[2] Consistent with the Board paper and the Operational Memorandum, the President established a Sanctions Committee in November 1998 to review allegations of fraud or corruption[3] and to recommend to the President sanctions to be imposed on those firms or individuals found to have engaged in fraudulent or corrupt activities.[4] The Committee's membership currently consists of the Managing Director overseeing Operations (Chair), the Senior Vice President and General Counsel, and two other senior staff selected for their operational experience (one Regional Vice-President and the current Vice-President, Human Resources).

2. The July 1996 Board paper and the January 1998 Operational Memorandum established a framework for the operations of the Sanctions Committee. The policies contained in these two documents provided the basis for procedures subsequently adopted by the Committee. These procedures can be summarized as follows:

a) Evidence of fraudulent or corrupt activities is compiled into a written report that also includes an explanation of the sanctions process. This report is called a "notice of debarment proceedings" as it serves to provide written notice of the allegations to the firm or individual concerned, as well as to explain the sanctions process. A subcommittee of the Sanctions Committee reviews the notice on behalf of the Committee to determine whether the evidence warrants that the allegations be sent to the firm or individual alleged to have engaged in

1 Fraud and Corruption - Proposed Amendments in the Bank's Loan Documents for the Purpose of Making Them More Effective in the Fight Against Fraud and Corruption, dated July 11, 1996 [Board Paper R96-112/1].

2 January 5, 1998 Operational Memorandum on Fraud and Corruption under Bank-Financed Contracts: Procedures for Dealing with Allegations against Bidders, Suppliers, Contractors, or Consultants.

3 The Bank's definitions of fraud and corruption are contained in the Procurement Guidelines and the Consultants Guidelines. "Corrupt practice" is defined as "the offering, giving, receiving, or soliciting of any thing of value to influence the action of a public official in the selection process or in contract execution," and "fraudulent practice" is defined as "a misrepresentation of facts in order to influence a selection process or the execution of a contract to the detriment of the Borrower, and includes collusive practices among consultants (prior to or after submission of proposals) designed to establish prices at artificial, non-competitive levels and to deprive the Borrower of the benefits of free and open competition."

4 The Committee is not involved in sanctioning staff or borrowers accused of such activities.

fraudulent or corrupt activities.[5] If the Committee finds that the facts contained in the notice are sufficient to support the allegations made, the Committee issues the notice to the respondent firm or individual.

b) Respondents are provided the opportunity to respond to the notice in writing within a certain period of time (at present, 60 working days). Respondents are also provided an opportunity to present their case orally, with legal counsel if they wish, at a hearing attended by the Committee.

c) Based on the written documentation submitted and information received during the hearing, the Committee makes a recommendation to the President as to whether there is reasonably sufficient evidence that the respondents engaged in corrupt or fraudulent practices and, if so, the proposed sanction. To date, sanctions have included periods of ineligibility (limited or indefinite) to be awarded a Bank-financed contract, letters of reprimand, and requirements that the respondent institute training and integrity programs for its employees. The respondent and the Executive Directors representing the borrowing country concerned and the country of incorporation or citizenship of the respondent are notified of the Committee's recommendation when it is made.

d) The President reflects on the recommendations of the Committee for a minimum of two weeks before issuing his decision. There is no appeal of the President's decision. Sanctions are posted on the Bank's external website.

II. The August 2001 Procedures

3. In August 2001, written procedures were issued for Sanctions Committee cases. These procedures (the "August 2001 Procedures") were finalized with the assistance of Mr. Richard Thornburgh[6] and issued after consultation with the Corporate Committee on Fraud and Corruption Policy. Management presented the August 2001 Procedures to the Audit Committee of the Board on October 5, 2001.

4. The August 2001 Procedures had three main objectives:

a) to reflect certain institutional changes, including the creation of a department responsible for conducting fraud and corruption investigations and preparing the notices of debarment proceedings (the Department of Institutional Integrity ("INT"));

b) to formalize practices previously followed by the Sanctions Committee; and

c) to provide an improved process to respondents, including (i) a more uniform conduct of the Committee's hearings; (ii) a stricter definition of the contents of the record submitted to the Committee for review, and (iii) a more rigorous division of responsibilities between INT, the Committee and its Secretariat.

5. In addition, the August 2001 Procedures clarify the intent underlying a provision in the July 1996 Board paper regarding the review and investigation of incidents having

5 The Committee labels firms and individuals alleged to have engaged in fraudulent or corrupt activities as "respondents." This term will be used for convenience throughout the remainder of this paper.

6 Mr. Thornburgh is a former Under-Secretary General of the United Nations and a former Attorney General of the United States.

occurred more than three years earlier. Because this provision was not intended to impose a statute of limitations precluding the Bank from investigating such allegations, the August 2001 Procedures grant the Director of INT the discretion to authorize investigations into allegations that occurred more than three years earlier. The effect of this is to allow the Director of INT to decide on a case-by-case basis whether a particular set of allegations is too old to investigate or whether it merits further inquiry due to other factors that raise important issues for the Bank.

6. Finally, in preparing the August 2001 Procedures, the Sanctions Committee recognized that the option provided in the January 1998 Operational Memorandum permitting respondents to cross-examine their accuser was, as a practical matter, impossible to implement. Respondents were not able to exercise this option because it required the consent of the accuser to be cross-examined. In practice, respondents were not able to obtain this consent, and so no accusers have submitted themselves for cross-examination. Hence, this option was not reflected in the August 2001 Procedures, and Management does not intend to re-introduce this practice in the contemplated revisions to these Procedures.

III. Experience to Date

7. Since its inception in November 1998, the Committee has dealt with thirty-two cases, the majority of them involving multiple respondents. In addition, there are five cases currently awaiting a hearing before the Committee and another 19 cases in earlier stages of the sanctions process. The Committee has offered "hearings" to all respondents, and a large majority of them have accepted the opportunity to make an oral presentation to the Committee.

8. To date, the Bank has declared 177 firms or individuals ineligible to participate in future Bank-financed procurement. Nine firms have received a letter of reprimand but remained eligible to participate in Bank-financed procurement. In 17 cases, the Committee decided not to sanction any respondent. Of the 177 debarments, 67 involved corruption (in some of these cases, fraud was also found). The remaining 110 debarments concerned fraud (including collusion among bidders). The debarments have ranged from a defined period of time (102 sanctions) to permanent ineligibility (75 sanctions). Debarments and reprimand letters are posted on the Bank's external website in order to ensure that the Bank's borrowers, as well as Bank staff, have easy access to such information when determining the eligibility of bidders for future Bank-financed contracts.

IV. Recommendations for Reforms of the Sanctions Process

9. Management's proposal to reform the sanctions process would introduce some significant changes to the existing process. The most significant changes include: (1) modification of the membership of the Sanctions Committee (to be renamed "Sanctions Board") to include both Bank staff and non-Bank staff, sitting in panels of three to decide cases; (2) establishment of a new staff position of "Evaluation and Suspension Officer" with the authority to issue temporary suspensions pending final resolution of cases on appeal to the Sanctions Board (the Evaluation and Suspension Officer's preliminary decisions would become final absent an appeal by the respondent or INT); and (3) introduction of measures to address a perceived need for lighter and more flexible sanctions, recognition of cooperation as a mitigating factor in sanctions determinations,

and additional incentives to contractors to disclose voluntarily information about fraud or corruption in Bank-financed projects.

A. Structure of the Sanctions Process

10. As noted above, the current structure of the sanctions process is two-tiered, with a Sanctions Committee composed of senior Bank managers making recommendations to the President for decision. Management's proposal to change the sanctions process retains a two-tier process, but removes the President from a role in such cases. Instead, a new staff position of "Evaluation and Suspension Officer" ("Evaluation Officer") is introduced as the first tier of the process, though with limited authority, and a Sanctions Board, composed of Bank staff and non-Bank staff, functions as the second tier of the process. These two key reforms to the sanctions process are addressed below.

(1) Composition of the Sanctions Board

11. There are three possible options for the composition of the Sanctions Board: (1) a committee composed entirely of Bank staff such as the current Sanctions Committee; (2) a committee composed entirely of members from outside the Bank; and (3) a committee composed of a mix of Bank staff and members from outside the Bank. After examining the reasons which advocate for a change from the existing membership of the Committee (*i.e.*, perceived conflicts of interest, potential external pressures, independence from the Bank), Management has decided to propose the third option.[7] Management believes that this option will benefit the process by providing the Committee with a combination of more independence and continued operational expertise in the procedures and guidelines associated with Bank-financed projects. As noted above, the Sanctions Committee would be renamed the Sanctions Board and would be reorganized to comprise seven members - three would be current Bank staff and four would be individuals who are not current Bank staff but are familiar with procurement matters, law, and Bank operations or operations of other international development banks.

12. The Bank staff members would be senior staff with knowledge of Bank procurement and operational processes and who would not be perceived to have real or apparent conflicts of interest. They would be appointed by the President. The Sanctions Board members from outside of the Bank would be appointed by the Executive Directors based on a recommendation from the President, similar to the manner in which the members of the Administrative Tribunal are appointed.[8] Such members would not include former Bank staff or consultants. The Sanctions Board would be authorized to sit in panels of three to hear cases, with two members of each panel being drawn from the group of non-Bank staff members. New Sanctions Board Procedures would contain clear conflict of interest provisions to ensure a greater perception of independence of the body.

13. The President would select a chairman of the entire Sanctions Board from the Bank staff appointed as members of the Board. The chairman's role would include the

7 This option is also supported by Mr. Thornburgh and Mr. André Faurès, a partner with Coudert Brothers LLP, Brussels. Both Mr. Thornburgh and Mr. Faurès were retained by the Bank to review the Bank's sanctions process and to provide recommendations for reforms to the process.

8 Article IV of the Administrative Tribunal's statute provides: "The members of the Tribunal shall be appointed by the Executive Directors of the Bank from a list of candidates nominated by the President of the Bank after appropriate consultation."

designation of panels, the supervision of the Sanctions Board's Secretariat, and the administration of the Sanctions Board's budget. In addition, the chairman would be responsible for establishing guidelines to ensure the smooth functioning of the Board and the hearings held by Board panels. The chairman will be appointed for one non-renewable three-year term.

14. The new composition of the Sanctions Board would enhance the independence of this body. The Thornburgh report noted that the current Sanctions Committee has been the target of claims by respondents of conflicts of interest, which have detracted from support for the Committee's decisions. At the same time, under its new composition, the Sanctions Board would continue to benefit from the operational expertise of Bank staff members sitting on the panels. Given the complex nature of many Bank projects, the importance of maintaining such expertise on the Sanctions Board should not be underestimated.

Management proposal:

15. Management proposes to establish a Sanctions Board to comprise seven members – three current Bank staff and four individuals who are not current Bank staff. The Bank staff members would be appointed by the President, while the non-Bank staff members would be appointed by the Executive Directors based on a recommendation from the President. The Sanctions Board would be authorized to sit in panels of three, with two members of each panel being drawn from the group of non-Bank staff members.

(2) Disposition and Interim Suspension by the Evaluation and Suspension Officer

16. Currently, as noted above, a subcommittee of the Sanctions Committee must clear a proposed notice of debarment proceedings before it is issued to the respondent. Furthermore, there is no mechanism to suspend temporarily a respondent pending the final outcome of the sanctions process. Management now proposes that a staff position of "Evaluation Officer" be created primarily for the purpose of making two initial determinations in the sanctions process: (1) whether the preponderance of evidence submitted by INT in a proposed notice of debarment proceedings leads to a finding that the respondent engaged in fraud or corruption, and (2) whether the respondent should be temporarily suspended from bidding on Bank-financed contracts pending the final outcome of the sanctions process. In addition, the Evaluation Officer would recommend a sanction to be imposed on the respondent, but this sanction would only become effective if the respondent elects not to challenge the allegations against it by appealing to the Sanctions Board. The Evaluation Officer would have the discretion to recommend a sanction that is different from the sanction proposed by INT in the notice of debarment proceedings, and it is the Evaluation Officer's recommendation that would become effective if the respondent did not appeal.

17. Thus, the Evaluation Officer's post would involve the following framework:

- First, the Evaluation Officer would receive a proposed notice of debarment proceedings from INT and determine whether there is sufficient evidence to issue the notice to the respondent.
- If the Evaluation Officer determines that this is the case, then he or she would issue the notice of debarment proceedings and recommend an appropriate sanction to be imposed on the respondent.

- Within a reasonable period of time, such as 45 working days from the date of issuance of the notice, the respondent would have an opportunity to explain in writing to the Evaluation Officer why, in its view, it should not be temporarily suspended from being eligible to participate in Bank-financed projects pending a final outcome of the proceedings.
- Following an additional period of time, such as 60 working days from the date of issuance of the notice, the respondent would be temporarily suspended unless the Evaluation Officer decides that suspension would not be appropriate.
- If the respondent decides to contest the allegations in the notice, the respondent files an answer to the allegations and the matter is placed before the Sanctions Board for its review and decision.
- Should the respondent decide not to contest the allegations within a specified period of time (*e.g.*, the 60 working days), the temporary suspension would be automatically converted into the sanction recommended by the Evaluation Officer unless INT requested that the Sanctions Board review the proposed sanction.
- Finally, the Evaluation Officer may, after examining a respondent's answer to the allegations in the notice, recommend that INT reconsider whether the case should proceed to the Sanctions Board. INT would retain the discretion to request that the case be submitted to the Sanctions Board for a decision.

18. The Sanctions Board will establish reasonable periods of time in new Sanctions Board Procedures for respondents and INT to file submissions in sanctions cases. The Sanctions Board may revise these time periods from time to time for future cases in light of experience gained with the new procedures.,. In any given case, and based upon a written request by a party, the Chairman of the Sanctions Board would have the discretion to increase the number of days for filings in pending cases as warranted by the circumstances of a specific case. It is noteworthy that these periods of time are not related to the time limitation proposed in paragraphs 28-31, infra. This new time limitation would not be subject to change without the approval of the Executive Directors.

19. The specific recommendation relating to the Evaluation Officer -- including the two distinct mechanisms of a first-tier review conducted by a Evaluation Officer and temporary suspension -- constitutes the most significant change to the current sanctions process. The main considerations underlying the recommendation with respect to temporary suspensions are that: (a) it would permit the Bank during the sanctions process -- which can be lengthy -- to restrict access to Bank-financed procurement of firms against which there is credible evidence of fraud or corruption; (b) it would reduce a respondent's incentive to use dilatory tactics and delay the proceedings while it received additional Bank-financed contracts; and (c) it would remove an incentive for a firm to contest the case at the Sanctions Board level solely for the purpose of delaying an inevitable declaration of ineligibility.

20. Furthermore, the initial review by the Evaluation Officer would potentially allow for the disposition of some cases without the necessity of a full hearing (thus decreasing the involvement by the Sanctions Board). Experience has shown that some respondents (such as shell companies bidding for Bank-financed contracts) do not challenge the allegations in the notice. Such firms would face debarment based on INT's investigative

findings and the Evaluation Officer's review, without the further step of an additional examination by the Sanctions Board. Nevertheless, any firm or individual contesting the allegations would have the right to appear before the Sanctions Board.

21. The benefits of the proposal to create the Evaluation Officer position outweigh certain perceived risks, including the substantial amount of discretionary authority resting with one Evaluation Officer, the need for consistency of standards regardless of the size or reputation of the respondent, and the possible adverse financial, reputational, or other consequences on a respondent resulting from a temporary suspension. Management is proposing effective mechanisms to address these perceived risks: (a) respondents are entitled to make submissions in writing conveying their view to the Evaluation Officer before the Evaluation Officer imposes a temporary suspension; (b) respondents are entitled to the benefits of a two-tier review process, involving a de novo review by a Sanctions Board whose membership combines greater independence and expertise in Bank operations; and (c) respondents would have the possibility of avoiding potential adverse publicity resulting from a temporary suspension imposed on them by agreeing to refrain from participating in Bank-financed procurement pending final resolution by the Sanctions Board. Otherwise, the suspension would be posted on the Bank's internal website[9] under a special category for temporary suspensions, a mechanism that would also, albeit to a lower degree, contain the risk of adverse publicity.

22. Management, while recognizing that the decision-making authority of such a Evaluation Officer would be substantial, is satisfied that the Evaluation Officer's authority would be balanced by the fact that his or her decision to impose a sanction would only become final if the respondent elects not to appeal to the Sanctions Board. Furthermore, the imposition of a temporary suspension would always be preceded by a determination made first by the Director of INT and subsequently by the Evaluation Officer that sufficient evidence exists to support the investigative findings of fraud or corruption. Management is also of the view that substituting a panel for the Evaluation Officer would substantially burden the proposed procedure and make it overly bureaucratic. Moreover, the proposed process is in line with best practices found in various national debarment rules that utilize an exclusion mechanism.[10]

23. Temporary suspension, in combination with the availability of review by the Sanctions Board, contributes to the objectives of fairness and administrative efficiency identified in Mr. Thornburgh's report both in terms of practical justification and of overall public purpose. Indeed, Management's proposed suspension mechanism provides the respondent with protection similar to or greater than equivalent administrative suspension mechanisms found under the domestic laws of some of the Bank's member countries.[11]

24. The Evaluation Officer would be appointed by the President and would report to the President. The Evaluation Officer's performance would be reviewed carefully on an

9 Such postings would be available to the Bank's borrowers through Client Connection. The intranet posting of temporary suspensions would include clear language that the Sanctions Board had not reached any finding of fraud or corruption with respect to the listed respondents.

10 For example, the U.S. Federal Acquisition Regulations, the French Code des Marchés, the China Tendering and Bidding Law, and the Turkish Public Procurement Law all provide for an exclusion of bidders based on the determination of a single government officer; furthermore, such exclusion is publicly disclosed.

11 See footnote 10 above.

annual basis given the importance of the position in the sanctions process. Selection criteria would include extensive knowledge of the Bank's operational policies, particularly in the area of procurement, as well as knowledge of and experience in the conduct of investigations, standards of proof and evidence, and legal issues relating to Bank operations. Management would also ensure that the Evaluation Officer has the necessary independence to make decisions on the cases investigated by INT and proposed for sanctioning, and that he or she does not have real or perceived conflicts of interest with respect to the cases that come under review. Management would take into account the need for a flexible deployment of resources, particularly in light of the fact that the caseload of the Evaluation Officer will be unpredictable and may not require a full-time commitment. Nevertheless, a deputy may be appointed to act on behalf of the Evaluation Officer when he or she is not available.

Management Proposal

25. Management therefore proposes that the Executive Directors approve the creation of a Evaluation Officer function with the authority to clear notices of debarment proceedings, to impose temporary suspensions, and, in the absence of a respondent's appeal to the Sanctions Board, to impose debarments as described in the preceding paragraphs.

(3) Final Decision on Imposition of Sanctions

26. The introduction of the Evaluation Officer position and a Sanctions Board composed of Bank staff and non-Bank staff eliminates the need for an additional review of sanctions cases by the President. The Sanctions Board's decisions would be final and not subject to review or appeal. The President would no longer play a role in the sanctions process, including in the voluntary disclosure program (described below in para. 39), other than to appoint the Bank staff who serve on the Sanctions Board. Mr. Wolfensohn has approved the proposal to remove the President from involvement in the sanctions process.

Management proposal:

27. Management proposes that under the new sanctions process, the Sanctions Board will have the authority to take decisions in cases without the involvement of the President of the World Bank.

B. Time Limitation

28. As noted in the discussion above, the August 2001 Procedures delegated to the Director of INT the discretion to determine whether or not to pursue allegations relating to events that occurred more than three years earlier. In his report, Mr. Thornburgh recommends that the Bank should not adopt any time limitation for sanctions cases. If the evidence before the Sanctions Board has met the standard of proof establishing that a respondent has engaged in fraudulent or corrupt practices, Mr. Thornburgh argues, it should not matter how long ago the incident occurred if the Bank wants to protect its funds from further misuse.

29. Some of the members of the Audit Committee expressed concern about the lack of a time limitation on sanctions cases and noted that almost all civil and criminal laws contain some form of time limitation. Management has considered the views of Mr.

Thornburgh, the views of the Audit Committee members, and the practice of other international bodies.[12] In the end, Management has decided to propose a statute of limitations.

30. Management's proposal is for a statute of limitations of ten years,[13] commencing from the final date of execution of the contract at issue and ending on the date when the Evaluation Officer submits a notice of debarment to the respondent. Because most fraud and corruption is purposefully concealed, Management has opted not to begin the statute of limitations from the date of the actual occurrence of such acts. Furthermore, Management's view is that the Bank should not adopt a commencement date tied to when the Bank "knew" or "became aware of" the alleged fraud or corruption. Such a commencement date would result in contentious and time-consuming disputes focused solely on when the Bank "knew" of allegations, rather than focusing on the more important issue of whether or not a respondent had engaged in fraud or corruption. For these reasons, Management has decided to focus on the more precise date of the last day of contract execution for the commencement of the statute of limitations.

Management proposal:

31. Management therefore proposes that the new sanctions process contain a ten-year time limitation commencing on the last date of execution of the contract involved.

C. Standard of Proof and Burden of Proof

32. Management proposes to replace the current standard of proof of "reasonably sufficient evidence" with the more descriptive standard of "more likely than not," in order to clarify the standard and achieve greater uniformity in its application. The "reasonably sufficient evidence" standard used by the Sanctions Committee is uncommon in both civil and criminal law. The August 2001 Procedures interpreted it to mean the same as the generally recognizable standard of "more likely than not" or "balance of probabilities," the usual standard in U.S. and U.K. civil cases (as opposed to "beyond a reasonable doubt," the standard of evidence used in criminal proceedings conducted in the U.S. and the U.K.).

33. Furthermore, Management proposes another clarification with respect to the burden of proof: INT should continue to have the burden of presenting sufficient evidence to meet the standard of proof. After INT has presented such evidence, however, the burden of proof will shift to the respondent to demonstrate why that respondent should not be sanctioned as a consequence of such behavior.

Management proposal:

34. Management proposes that the standard of proof in the sanctions process be changed to "more likely than not" so that the Sanctions Board would have to conclude on the basis of a preponderance of the evidence that the respondent engaged in fraud or corruption.

12 Neither the United Nations nor the European Commission impose time limitations on their investigations that may lead to the debarment of contractors.

13 A ten-year time limitation is consistent with French Penal Code which contains a statute of limitations of ten years for criminal conduct.

D. Range of Possible Sanctions

35. To date, the Sanctions Committee has imposed a limited number of possible sanctions: a periods of ineligibility (limited or indefinite) to be awarded a Bank-financed contract, a letter of reprimand, and a requirement that the respondent institute training and integrity programs for its workers. Management now proposes that the types of sanctions available to the Evaluation Officer and the Sanctions Board be expanded to include: (1) conditional non-debarment, (2) temporary debarment with conditional release, and (3) restitution requirements. Under a conditional non-debarment, the Sanctions Board would require a respondent to undertake certain required acts (such as a compliance program), and failing to do so would result in the debarment of the respondent for a specified period of time. Under a temporary debarment with conditional release, on the other hand, a respondent would be declared ineligible for a stated period of time but would only become eligible again after that period if it had complied with the conditions of release (such as restitution to the borrower). Mr. Thornburgh has noted the desirability of having a broad range of sanctions. Indeed, this need for more flexibility has already led the Sanctions Committee to issue public letters of reprimand as another form of sanction. Management would establish guidelines to govern the application of sanctions by the Evaluation Officer and the Sanctions Board.

Management proposal:

36. Management proposes that the range of sanctions available to the Evaluation Officer and the Sanctions Board include: (1) debarment, (2) letters of reprimand, (3) the initiation and adoption of compliance programs, (4) conditional non-debarment, (5) temporary debarment with conditional release, and (6) restitution requirements. Management further proposes that, as is the case in the current Sanctions Committee Procedures, the identity of the sanctioned party as well as the sanction imposed be made public, including on the Bank's external website. As part of the INT Communications Strategy, which will shortly be submitted to the Executive Directors, Management will propose a further amendment to the World Bank Policy on the Disclosure of Information in order to address the disclosure of additional information related to sanctions.

E. Incentives for Cooperation and the Assessment of Aggravating and Mitigating Factors

37. Management notes that the current practice of taking into consideration a number of factors that may affect the sanction imposed upon a respondent should continue to be applicable under the new framework. Factors that could be either aggravating or mitigating include circumstances relating to the alleged acts, such as the pattern of a respondent's previous activities in Bank-financed projects, the degree of involvement of a particular respondent in the alleged act of fraud or corruption, whether or not corruption is involved (as opposed to only fraud), and the involvement of or bribery of Bank staff. In addition, aggravating or mitigating factors would include circumstances that relate to the respondent's conduct in the course of the Bank's investigation. For example, mitigating factors would include cooperation by the respondent in the Bank's investigation, and aggravating factors would include the destruction of evidence by the respondent. The consideration of aggravating and mitigating factors would be designed to achieve the particular purpose to be served by the sanctioning process, *i.e.*, debarment, general deterrence, specific deterrence, rehabilitation, and restitution.

38. Because of the limited nature of the Bank's ability to investigate allegations of fraud and corruption, Management considers that it is important and indeed necessary in appropriate situations to provide incentives to individuals and firms outside of the institution to cooperate with the Bank to allow the Bank to discharge its fiduciary responsibilities to its shareholders. The recognition of cooperation as a mitigating factor in sanctions determinations is an important tool that the Bank needs to consider. Management notes, however, that the sanction imposed on a respondent will only reflect the respondent's cooperation in those cases where the information provided -- the quid pro quo -- has been of real benefit to the Bank.

39. In order to facilitate investigations and the sanctions process, Management believes another important tool needed in the Bank's fraud and corruption work is to allow for the possibility of the negotiated resolution of sanctions cases through a voluntary disclosure program. The voluntary disclosure program would establish a process whereby INT would recommend to the Sanctions Board a lesser sanction to be agreed upon with the firm or individual participating in the program (the "participant") in exchange for information provided by the participant. That sanction would take into account the importance of the voluntary admissions made by the participant as well as additional evidence of fraud or corruption provided by the participant concerning third parties. Such a program would permit disclosures by firms or individuals of information relating to fraud or corruption in Bank-financed operations where the Bank had not previously received such information and was unlikely to have access to such evidence without the participant's cooperation. The principal objective of this proposal is to provide potential participants with an incentive to come forward voluntarily and to disclose important information to the institution about fraudulent and corrupt practices in Bank-financed operations. In exchange, participants would receive recognition for their cooperation in the form of a lesser sanction if the information is deemed to be credible and of value to the Bank. The Bank will develop a set of procedures to govern the voluntary disclosure program. Management will share these procedures with the Audit Committee and will implement the program only after consultations with the Audit Committee on the proposed procedures.

Management proposal:

40. Management proposes that the Evaluation Officer and the Sanctions Board be authorized to consider aggravating or mitigating factors in determining an appropriate sanction of respondents. Such factors will include circumstances relating to the alleged acts of fraud or corruption committed by a respondent as well as its conduct during the course of the Bank's investigation. Furthermore, Management proposes to adopt a voluntary disclosure program that permits firms or individuals to report fraud or corruption in Bank-financed contracts and to allow those firms or individuals to receive mitigation for their cooperation in the form of a lighter sanction.

F. Parties Subject to Sanctions

41. Based on its early experience, the Sanctions Committee found its authority too restricted when dealing with individuals who maintained indirect control over shell companies used to divert funds in Bank-financed projects. Management seeks Board approval for the Evaluation Officer and the Sanctions Board to impose sanctions on any individual or organization that at any time directly or indirectly controls or is controlled by a respondent. This would be both a more expansive and flexible reach of the

Sanctions Board's jurisdiction than envisaged in the 1996 Board paper and the January 1998 Operational Memorandum, which automatically extends the reach of a debarment to "any firm that owns the majority of the accused firm's capital, or of which the accused firm owns the majority of the capital."[14] The August 2001 Procedures already provide that "the Committee may recommend to the President that an appropriate sanction be imposed on any individual or organization that, directly or indirectly, controls or is controlled by the Respondent."[15]

42. The rationale behind broadening the jurisdiction of the Sanctions Board is to prevent a debarred respondent (including its owners and officers in a controlling position) from creating a new firm in order to circumvent the consequences of a debarment decision.

Management proposal:

43. Management proposes that the parties subject to sanctions include any individual or organization that directly or indirectly controls, or is controlled by, a respondent.

G. Scope of Debarments

44. In the course of the July 23 Audit Committee meeting, one Committee member voiced a concern about the lack of applicability of the sanctions process to projects supported by Bank or IDA guarantees, as well as to MIGA's and IFC's activities. The Bank's sanctions process has been limited to IBRD loans and IDA credits.

45. The Bank and IDA will incorporate the appropriate provisions into their respective agreements for guarantee operations so that firms or individuals found to have engaged in fraud or corruption in connection with a project benefiting from such guarantees may be subject to the sanctions process. IFC and MIGA have submitted a separate paper to the Executive Directors on the sanctions process. [Board Paper R2004-0025/1, IDA/R2004-0031/1, IFC/R2004-0031/1, MIGA/R2004-0010/1]

Management proposal:

46. The Bank's sanctions process will be made applicable to IBRD and IDA guarantee operations, which will necessitate a minor revision of the Bank's procurement eligibility rules.

H. Change in Procurement Policies

47. Certain other reforms related to the changes to the sanctions process but of a more operational nature, such as amending the definitions of fraud and corruption[16] and increasing the Bank's access to bid and contract documentation,[17] have been reflected in

14 January 1998 Operational Memorandum at para. 5.

15 August 2001 Procedures, Section 13(d).

16 See Guidelines: Procurement under IBRD Loans and IDA Credits and Guidelines: Selection and Employment of Consultants by World Bank Borrowers: Proposed Modifications [Board Paper R2003-0129; IDA/R2003-0152], paragraph 1.14.

17 Id.

the proposed revisions to the Procurement and Consultants Guidelines recently approved by the Board.

48. In the Audit Committee meeting, one member noted that the additional burden resulting from the requirement to increase the Bank's access to bidders' documentation will be essentially borne by client countries since it would be incumbent upon client countries' agencies to maintain a procurement record comprising all bids for a yet undetermined period of time. Any additional obligation placed on client countries, particularly under national competitive bidding which is governed by the borrower's specific procurement rules,[18] should be carefully examined with a view to striking the right balance between the interests of Borrowers on the one hand, and the interests of the Bank in gaining access to pertinent information on the other hand.

I. Cost Estimate

49. Management estimates the total cost of implementing the recommendations detailed above would be about $500,000 per year. This estimate includes the costs associated with (i) the Evaluation Officer and one support staff, (ii) Sanctions Board members chosen from within the Bank, (iii) Sanctions Board members who are not current Bank staff, and (iv) the Secretariat of the Sanctions Board.

Summary of Recommendations

50. On the basis of the foregoing and in summary, Management recommends adoption of the following reforms to the sanctions process:

a) Establishment of a Sanctions Board to comprise seven members – three Bank staff and four individuals who are not Bank staff. The Bank staff members would be appointed by the President, while the non-Bank staff members would be appointed by the Executive Directors based on a recommendation from the President. The Sanctions Board would be authorized to sit in panels of three, with two members of each panel being drawn from the group of non-Bank staff members.

b) Introduction of an Evaluation Officer with the authority to clear notices of debarment proceedings to be sent to the respondents involved, to impose temporary suspensions on his or her own, and to recommend sanctions that will become effective if there is no appeal to the Sanctions Board.

c) Authorization for the Sanctions Board to take decisions in sanctions cases without the involvement of the President of the World Bank.

d) The introduction of a ten-year time limitation period commencing from the final date of contract execution and ending on the date when the Evaluation Officer submits a notice of debarment to the respondent. .

e) Revision of the standard of proof in the sanctions process to "more likely than not."

[18] National procurement laws generally do not include a requirement that public agencies should file losing bids once the bid protest period has elapsed.

f) Expansion of the range of sanctions available to the Evaluation Officer and the Sanctions Board to include: (1) temporary or indefinite ineligibility, (2) letters of reprimand, (3) the initiation and adoption of compliance programs, (4) conditional non-debarment, (5) temporary debarment with conditional release, and (6) restitution requirements.

g) Publication of all sanctions and the identity of the sanctioned party.

h) Authorization for the Evaluation Officer and the Sanctions Board to consider aggravating or mitigating factors in determining an appropriate sanction of respondents, including circumstances relating to respondents' conduct during the Bank's investigations.

i) Adoption of a voluntary disclosure program that permits firms or individuals to report fraud or corruption in Bank-financed contracts and to allow those firms or individuals to receive recognition for their cooperation in the form of a lesser sanction through a negotiated resolution process.

j) Restatement of the parties subject to sanctions to include any individual or organization that directly or indirectly controls or is controlled by a respondent.

k) Application of the sanctions process to IBRD and IDA guarantee operations.

51. If the changes above are approved by the Executive Directors, Management will implement the recommended reforms to the sanctions process by revising and supplementing the August 2001 Procedures as necessary.

52. In addition, Management will proceed with the following specific work:

a) Preparation of new Sanctions Board Procedures to reflect the new process with an Evaluation and Suspension Officer and a Sanctions Board.

b) Preparation of conflict of interest guidelines for members of the Sanctions Board;

c) Preparation of Terms of Reference for the Evaluation Officer;

d) Preparation of sanctioning guidelines for the Evaluation Officer and the Sanctions Board to consider in imposing sanctions on respondents;

e) Preparation of a mechanism for temporary suspensions to be posted on the Bank's internal website pending a final resolution of respondents' cases before the Sanctions Board.

f) Preparation of guidelines for implementation of the Voluntary Disclosure Program.

53. Finally, Management intends to prepare a separate note to the Board on the detailed application of the Bank's sanctions process to the beneficiaries of IBRD and IDA guarantee agreements.

Chapter 29

Compliance with Anti-Corruption Laws Through Access to Public Procurement: The Asian Development Bank Experience

by

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"Commit the oldest sins the newest kind of ways," is a line from William Shakespeare's *Henry IV, Part II*, which really captures the creativity of those committed to corruption or fraud. No matter how hard we try, whether through individual or collective efforts, to find it, and no matter how well we think we are controlling and fighting it, everyone knows corruption will occur, somehow, somewhere, to some degree. The innovation and creativity of the corrupt simply make it too hard to stop completely. So a discussion of fighting corruption in public procurement is not complete just addressing what to do to prevent or detect corruption in public procurement. The discussion needs to also address what happens when we find it.

Penalties are an essential deterrent. Most, if not all countries' legal and judicial systems provide for a penalty for fraud or corruption. Multilateral institutions have administrative penalties to punish transgressors. ADB's Anticorruption Unit has dealt with some difficult cases that resulted in debarment—ineligibility—of more than 200 individuals and firms. There is nothing purposely malevolent about our actions. If we conclude, for example, that a company has violated our Anticorruption Policy, we ask the company to first explain its actions. Many firms take actions that assure us the same violation is unlikely to recur, which is considered when ADB determines the firm's penalty. And that's where our strength lies: a desire to ensure that, if possible, the firm does not fold, but seeks to meet the broadly accepted criteria that would allow more contracts for it in the future, and indeed more jobs for the people. At ADB, we have tried to carefully balance the desire to punish with the better interest to reform.

Punishment is not easy to implement. Last year, there was an interesting article in the *International Herald Tribune* for which the headline was, "A Clear-Cut Decision Isn't So Clear Anymore." It talked about a German company that had supplied poison gas to the Nazis being prevented, 60 years later, from participating as a subcontractor for a holocaust memorial. Some of the most important questions raised in that article were:

- Was the memorial's board correct to punish the firm?
- Why should one firm be singled out for penalty, when so many others committed similar acts?
- At what point does a company earn exoneration for its past behaviour? In this case, 60 years had passed since its transgressions.

This is the difficult situation that institutions like ADB find themselves in. They are seeking to curb corruption while at the same time ensure that government and civil society are interested enough to partner such efforts. That way lies the future policy; however, in the interim we need to be more proactive in dealing with corruption wherever we find it, and more importantly are able to identify it.

Is voluntary self-regulation enough? Can a reform agenda without ownership by all stakeholders be successful? Where ownership is limited to periodic rhetorical comments for reasons to do with powerful pressure groups that support the *status quo,* there is not likely much meaningful self-regulation. Yet penalties, whether criminal, civil, or administrative, for those who commit fraud and corruption, may jeopardise the entity's very existence. The question then arises as to what one ought to do. If sanctions are not effective and if voluntary self-regulation is not forthcoming then what is the ideal way to stop stakeholders from continuing to disregard public opinion for their narrow self-interest?

ADB has tried to balance all these factors to address fraud and corruption in its projects, the majority of which is related to public procurement. The investigation and sanction process can be completed in days, if necessary. Usually it takes months—often the better part of a year. And sometimes it takes more than a year.

Screening and Investigation

ADB has established an Anticorruption Unit within the Office of the Auditor General to handle all matters related to allegations of fraud and corruption. The Anticorruption Unit's investigative procedures follow internationally accepted principles and incorporate due process in its administrative procedures.

The Anticorruption Unit screens any allegation or evidence of fraud or corruption related to ADB-financed activity to determine whether it warrants further investigation. While the Anticorruption Unit receives and screens anonymous submissions, it encourages anyone submitting an allegation or evidence to do so on an identified basis to facilitate investigation.

The Anticorruption Unit treats sources of allegations of fraud or corruption with the utmost confidentiality and discretion.

To the extent possible, The Anticorruption Unit will give the subject of investigation an opportunity to comment in writing on the allegation(s) and to bring to the Oversight Committee on Anticorruption's attention any other relevant information.

Sanctions

When an investigation is complete, The Anticorruption Unit will submit its findings to ADB's Oversight Committee on Anticorruption. The Oversight Committee consists of three regular voting members among ADB's senior staff, and three alternate members who fill any vacancies that may occur among the regular members due to absence or conflict of interest. Members are nominated by the Auditor General and approved by the President. The heads of ADB's Budget, Personnel and Management Systems Department and Central Operations Services Office (or their designees), and an Assistant General Counsel designated by the General Counsel advise the Oversight Committee.

The Oversight Committee retains sole discretion to determine the relevance of the evidence submitted before it.

On the basis of The Anticorruption Unit's findings, and taking into consideration the submissions of the subject of investigation, the Oversight Committee will assess whether the alleged violation took place, if the case should continue for further inquiry, or if the case should close.

If the Oversight Committee determines that the subject of investigation has engaged in fraudulent or corrupt practices as defined by ADB's Anticorruption Policy in any ADB-financed operations, it then decides what sanction or remedial action ADB should impose. ADB may declare a firm or individual ineligible from participating in ADB-financed projects and activities for a specified period of time or indefinitely. ADB may refuse to finance certain expenditures, suspend disbursements, accelerate maturities of loans, or cancel loans.

If ADB consistently encounters problems within a particular executing agency or sector, it could change its programming mix to avoid future lending and Technical

Assistance operations in that area. In consultation with the member country, ADB can also focus its lending and Technical Assistance programme upon strengthening government institutions, nongovernmental organisations, and civil society to facilitate greater transparency and accountability in that sector.

For borrowers, ADB may cancel the portion of a loan allocated to a contract for goods or works if it determines that representatives of the borrower or a beneficiary of the loan engaged in corrupt or fraudulent practices. If ADB determines that corruption has reached such proportions that it is a significant impediment to the integrity of ADB operations or the attainment of a country's fundamental development objectives, it could elect to suspend ADB lending and Technical Assistance operations to that country. Conversely, where a member country has made significant progress in improving the efficiency, effectiveness, and integrity of its public and private sectors, ADB may accelerate the lending programme or provide additional Technical Assistance resources to ensure sustainability of the reforms.

Appeals

Individuals and firms may appeal sanctions to a Review Committee on Anticorruption, composed of three Vice-Presidents. (The Auditor General and General Counsel, or their designated representatives, are present in a nonvoting capacity.) The applicant must submit an appeal within 90 days from the date ADB issued the Oversight Committee's decision, which it provides either by written notice or by posting on its public Web site only if a written notice cannot be delivered. Appeals must be in writing and must clearly and succinctly state the reason(s) for the requested review of the decision of the Oversight Committee.

The Review Committee shall consider any new information to the extent that such information was not known, or could not reasonably have been known, to the firm or the individual at the time that the Oversight Committee sought explanations and such information is relevant to the decision of the Oversight Committee. The decision of the Review Committee on any such appeal is final and binding and not subject to further appeal.

The Review Committee must reach consensus of all members to render a decision. If it cannot reach a unanimous decision, the Chair will refer the matter to the President to resolve the differences and reach a unanimous decision. If a unanimous decision is still not possible, the President shall make a final decision.

Recent Changes

Since September 1999, when ADB established it, the Anticorruption Unit has gained much experience in addressing concerns of fraud and corruption, much of which relates to public procurement. ADB recently adopted some policy changes to address some of the critical issues that affect the daily activities of the Anticorruption Unit and its ability to assure and promote the ethical standards required by ADB's Anticorruption Policy.

ADB found its fraud and corruption terms were too narrowly defined, and focused on procurement issues. While procurement is the focus of this OECD Global Forum, it does not encompass all fraud and corruption. So ADB's fraud and corruption terms constrained the Anticorruption Unit's investigations. In addition, the Anticorruption Policy, adopted in 1998, limited remedial actions to ineligibility to be awarded ADB-

financed contracts. ADB recognised that the constraint could place it in a position where parties that ADB has found not to have maintained the highest ethical standards may find ways to participate in ADB-financed activities other than being awarded contracts. For example, such a party may be a subcontractor or supplier without being awarded an ADB-financed contract, or may actively participate in an ADB-financed seminar.

ADB's Board of Directors approved clarifications to ADB's Anticorruption Policy on 11 November 2004, and related changes to consulting and procurement guidelines. The changes were critical to the Anticorruption Unit's day-to-day activities, and will make clear to all parties doing business with ADB (or who are thinking of doing business with ADB) that ADB expects the highest standards of ethical behaviour. The clarifications

- revise fraud and corruption terms and definitions and define "conflict of interest";
- remove a constraint on the scope of the Anticorruption Unit's investigative work (removing the constraint that investigations were limited to only reviewing allegations directly related to ADB-financed activity); and
- give ADB flexibility in sanctions it may impose on parties who violate the Policy.

Outstanding Issues

ADB's Auditor General and the Anticorruption Unit realise from their discussions with ADB's Board of Directors, as well as the recent high levels of donor scrutiny regarding how well multilateral development banks (MDBs) address fraud and corruption, that there will still be strong efforts to enhance ADB's existing, effective procedures. Two of the most important issues that remain are

- cross debarment (If one MDB imposes a sanction on an entity based on the respective MDB's administrative policy, should all MDBs automatically do the same?); and
- criminal referrals (What is the obligation of MDBs to refer their administrative findings to legal and judicial authorities?).

ADB does neither of these routinely, though its anticorruption procedures allow both. The Anticorruption Unit and its counterparts at other MDBs continue to discuss these and other relevant issues at working-group meeting on MDB anticorruption issues, annual International Investigators Conferences, and International Group for Anti-Corruption Coordination meetings. The issues are not simple.

Before MDBs should establish a consistent practice of cross debarment, there needs to be standard policies, terms, definitions, and procedures among the MDBs, as well as a uniform sanction policy. These do not currently exist, and as ADB found in updating its own fraud and corruption-related terms and definitions, it likely will not be easy to achieve. Without such standardisation, it is difficult if not impossible, for ADB's Oversight Committee on Anticorruption to determine appropriate sanctions. Also to be considered is a key principle of ADB's administrative due process to treat large and small firms alike. Cross debarment creates a very real potential to put small firms out of business, which is contrary to ADB procedures (though, yes, it is possible that ADB could change its procedures), while large firms are much more likely able to weather such a storm.

Making criminal referrals a practice blurs the line between an MDB's administrative process and legal and judicial processes. For ADB, one of the critical issues is its adherence to a principle of administrative due process, which the Anticorruption Unit has steadfastly maintained means treating everyone equally. A major issue to consider is that ADB has defined fraud and corruption terms in one way, and applies that perspective throughout its operations. But ADB's 63 member countries may have different perspectives and legal definitions of fraud and corruption that differ from ADB's. Also, the Anticorruption Unit has concluded that some member countries' legal and judicial systems lack the capacity to consistently address cases following principles of good governance: transparency, accountability, and reliable predictability. The Anticorruption Unit decided if it cannot refer all cases, thereby treating all entities equally, as a practice it should not make such referrals. ADB does review on a case-by-case basis if such referrals should be made, and ADB does not discourage legal and judicial processes by its member countries. When asked, ADB has found ways to support its members' legal or judicial efforts of fraud and corruption cases.

Chapter 30

Exclusion of Tenderers in the European Union: The Only Way Forward Against Procurement Fraud?

by

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Introduction

Blacklisting has been hailed as an impressive deterrent in the fight against corruption and procurement fraud. The reality, however, is a bit more complex, and it may be some time before blacklisting will be capable of offering an effective deterrent. Some of the critical issues around blacklisting are highlighted in this paper, with examples from the European Union (EU) and the World Bank. The question addressed here is whether the EU can learn anything from the World Bank debarment process.

The structure of this paper is as follows. First, an overview of a variety of "exclusion" practices is given. EU and World Bank practices are then described and discussed. A conclusion tentatively suggests that whitelisting may be more appropriate for the EU at the present time.

Exclusion practices: An overview

Exclusion practices include (i) an authority or organisation excluding a tenderer from a tender at a particular stage of the tendering process; (ii) excluding a tenderer from tendering for contracts emanating from a particular authority or organisation for a particular period – typically three or five years (also called temporary debarment); (iii) excluding a tenderer from tendering for contracts emanating from a particular authority or organisation for an indefinite period.

Decisions to exclude may be taken by either an administrative body or a judicial body. Decisions may affect either a legal person or a natural person.

Situation in the EU

Article 45(1) of the Directive 2004/18/EC of the European Parliament and Council requires Member States to exclude certain tenderers from participation in a public contract. The extent of this obligation follows.

> *Any candidate or tenderer who has been the subject of a conviction by final judgment of which the contracting authority is aware for one or more of the reasons listed below shall be excluded from participation in a public contract: (a) participation in a criminal organisation, as defined in Article 2(1) of Council Joint Action 98/733/JHA(1); (b) corruption, as defined in Article 3 of the Council Act of 26 May 1997 (2) and Article 3(1) of Council Joint Action 98/742/JHA (3) respectively; (c) fraud within the meaning of Article 1 of the Convention relating to the protection of the Financial interests of the European Communities(4); (d) money laundering, as defined in Article 1 of Council Directive 91/308 of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering.*

Article 45(1) does not make it possible to exclude tenderers on the basis of suspicion.

Article 45(2) makes it possible for Member States to exclude economic operators from participation in a contract on a number of grounds: bankruptcy, grave professional misconduct, a final judgment on matters other than provided in Article 45(1), breach of social security regulations, failure to pay taxes, failure to supply information as required by the Directive or misrepresentation. These provisions have been variously interpreted by the Member States.

The European institutions also exclude tenderers and economic operators, on similar grounds and in accordance with the Financial Regulation. In addition, the European Commission has operated an internal "Early Warning System", since 1997, which is presently being reviewed in search of effectiveness.

A number of issues impact on the potential effectiveness of exclusion as a deterrent in the EU.

1. The impact of the res judicata *requirement*

Article 45(1) is usually interpreted to mean that following a final judgment for the type of offence mentioned above, a tenderer must be excluded. Waiting for a final judgment can mean a delay of 10 years or more before a tenderer can be excluded.

2. Impact of plea bargaining

In systems where plea bargaining or equivalent practices apply, this may result in exclusion being altered or waived.

3. Criminal liability of legal persons

The exclusion of a legal person from tendering may depend on the extent to which they can be held criminally liable for the types of offences mentioned in Article 45. Some offences may not apply to legal persons in practice. With respect to corruption offences, it should be noted that it is unusual for a legal person to be found guilty of corruption, although a natural person may be found guilty in its stead.

4. Legal persons: extent of exclusion

It is not clear whether the exclusion of a legal person would include its subsidiaries.

5. Information gap

There is no common approach at EU level concerning the publication of excluded tenderers and to what extent this information should be shared.

6. Rules for reinstatement

These rules are not uniform; the rights of redress after wrongful exclusion vary from Member State to Member State.

7. Front companies

Exclusion practices do not resolve the problem of front companies.

World Bank

The World Bank has a well-publicised "debarment" policy. We should therefore be able to learn from their experience how to make this mechanism more effective.

The World Bank has an internal system for imposing sanctions. It is now proposing to extend this possibility to all its guarantee operations. The standard of evidence will be "more likely than not". On this basis, the Bank "will sanction a firm or individual, including declaring ineligible, either indefinitely or for a stated period of time, to be awarded a Bank-financed contract if it at any time determines that the firm has, directly

or through an agent, engaged in corrupt, fraudulent, collusive, or coercive practices in competing for, or in executing, a Bank-financed project."[1]

A list of excluded tenderers will continue to be published on the Internet. In addition temporary suspensions will also be posted on the Bank's internal Web site pending a final resolution of respondents' cases before the sanction board. The scheme will be supplemented by a Voluntary Disclosure Programme (VDP), encouraging firms and individuals to report fraud or corruption in Bank-financed contracts.

One difficult question is of knowing whether voluntary disclosure could be used to enhance reporting in the European context. Voluntary disclosure implies a bargaining process – the discloser is promised leniency, in return for information. Although in the tax field this often means giving information about one's own tax affairs, in the context of procurement and corruption it involves giving information about others – sometimes competitors. This has the advantage of providing the (sanctioning) authorities with valuable information. One essential prerequisite is that the competent authority is in a position to be lenient, that is to say, to apply lesser sanctions or to waive them altogether.

Discussion

The experience of the EU institutions presently shows that it is difficult to exclude on the basis of an internal mechanism unless a proper system of sanctions exists. Also, without publicity, it is often difficult to ensure that information reaches the intended audience. There may be lessons to be learnt here, as far as the Early Warning System is concerned.

The possibility of excluding tenderers at EU level offers a potential deterrent, which may give a false sense of security. It will be useful to monitor how many tenderers are excluded on the basis of their criminal convictions by the Member States and whether the exclusion is communicated to other authorities.

Although it might be possible for the EU to emulate the World Bank and introduce a publicity requirement both for Member States and for the European Institutions, it might be more difficult to introduce voluntary disclosure as an option. Voluntary disclosure may in any case prove to be unpalatable as an idea at the level of the EU institutions, for historical or cultural reasons. It may be seen by some as institutionalising an indirect form of market competition.

Conclusion

Until exclusion practices can be rendered more effective – and some reflection is needed here – it might be useful to look at the possibility of introducing whitelisting, as a complementary measure and as one that offers an incentive. Whitelisting is an approach that requires companies likely to bid to certify compliance with anti-bribery laws and prove that they have adequate internal management and accounting practices to ensure compliance. This might go some way towards deterring uncompetitive and costly market phenomena.

[1] World Bank Guidelines Procurement Under IBRD Loans and IDA Credits, http://siteresources.worldbank.org/INTPROCUREMENT/Resources/Procurement-May-2004.pdf

Chapter 31

Italy's Anti-Corruption Legislation: Disqualification from Public Bidding as a Sanction

by

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Introduction

Italy implemented the OECD Anti-Bribery Convention through the adoption of a statute that came into force on 26 October 2000 (Act no. 300/2000).[1] The implementing law amended the Criminal Code by establishing the offence of bribing a foreign public official (Article 322-bis). In addition, pursuant to Article 11 of the implementing law, the Government was to issue a Legislative Decree[2] within 8 months of the entry into force of the law regarding the administrative liability of legal persons. On 8 June 2001, the Italian Government issued the Legislative Decree no. 231/2001. Pursuant to that statute, administrative liability may be attributed to certain bodies for certain criminal offences (including the bribery of foreign public officials).

Although the Legislative Decree no. 231/2001 expressly established a form of administrative responsibility, some commentators[3] denounced the "labelling fraud" allegedly perpetrated by the legislator, sustaining that the statute had actually introduced a criminal form of responsibility. Other commentators[4] adopted a more agnostic view, underlining that the new legislation shows some ambiguous features, falling in between administrative and criminal liability. This paper will adopt this second approach, deemed more consistent with the Convention and its Commentaries, which provide for the option of not establishing criminal responsibility for foreign bribery where a Party does not already have criminal responsibility of legal persons in its legal system. Consequently the question arising from the dispute over the "true" nature of the responsibility introduced by this statute will not be addressed.

While the paper focuses on disqualification from participating in public procurement as a sanction to legal persons involved in corruption, a brief examination of the principal characteristics of the statute will be necessary to understand fully the legal framework into which the aforementioned sanction fits.

Entities covered by the new law

Under Article 1 of Legislative Decree no. 231/2001, not only legal persons and corporations, but also associations (including those who do not have legal personality) may be held liable under Article 1 paragraph 2 of the statute, with the exclusion of the state, regions and municipalities. Public agencies and public enterprises that do not operate in the relevant market on a normal commercial basis are also excluded (Article 1 paragraph 3). An exclusion is also established for bodies of "constitutional relevance" (Article 1 paragraph 3), this expression basically making reference to trade unions and political parties.[5]

Standards of liability

The statute creates two types of corporate liability. The first closely resembles the "classic" identification doctrine, but broadens its scope by widening the range of natural persons whose acts may lead to corporate liability: the organisation will be held liable for crimes committed in its interest *or* for its benefit by a person acting in a "leading position" (*Soggetti in posizione apicale*). Under Article 5(1)(a), a person in a "leading position" means anyone who, legally or *de facto*, acts as representative, director or manager. While the Government's Commentaries on the definitive draft statute[6] expressly state that the "benefit" and "interest" clauses should be regarded as two alternative requisites, some commentators[7] maintained that they should be considered as a single

requisite. Should this second view be adopted by the courts, a corporation will not be held liable if it cannot possibly obtain any benefit from a crime committed in its interest by one of its agents. Moreover, under Article 5(2), the organisation will not be held liable if the perpetrator commits the crime exclusively in his/her own interest or in the interest of a third party.

The adoption of this extended version of the identification doctrine has not been straightforward: a due diligence affirmative defence is provided for under Article 6(1). To avail of this defence the organisation must prove that:

> "(a) the directing board has enacted and effectively applied, before the offence was committed, organisational and managerial schemes appropriate for the prevention of offences of the same type of the one that was committed;
>
> (b) the duty to supervise and update the schemes has been given to a body with autonomous powers of initiating controls;
>
> (c) the offenders committed the crimes by fraudulently evading the organisational and managerial schemes;
>
> (d) there has not been a lack of supervision by the body listed under (b)."

Article 6(2) provides for some minimum requisites that the organisational schemes have to satisfy to be considered effective. In any case, under Article 6(5), the profit that the organisation earned from the commission of the crime will be subject to confiscation.[8]

Articles 5(1)(b) and 7 establish a second type of corporate liability. Under Article 5(1)(b), an organisation will be held liable for the offences committed in its interest or for its profit by persons subject to the direction or control of one of the persons listed under (a) (*i.e.* the ones acting in a "leading position"). Under Article 7, the organisational schemes are relevant also for this second type of liability, but they do not come into play as an element of an affirmative defence: according to the prevailing opinion[9], in order to have the organisation declared liable for an offence committed by a subordinate, the prosecution must prove that the organisation failed to set up the organisational schemes or that the schemes enacted were not effective.

As the aforementioned Government's Commentaries expressly admit, the "organisational schemes" were inspired by the compliance programmes provided for by the United States Federal Sentencing Guidelines. Notwithstanding some differences in the minimum requisites, an organisational scheme and a compliance programme are basically the same: an effective system of controls aimed at minimising the risk of an offence being committed. This system of controls, however, plays different roles in the Italian and in the American corporate liability systems. While in the United States the system of controls comes into play at the sentencing stage and only for crimes committed by subordinates (possibly mitigating the penalty but not averting criminal liability), in Italy it acts either as an element of an affirmative defence (for crimes committed by higher ranking agents), or as a negligence standard (for crimes committed by subordinates).

Under Article 8, the statute establishes what could have been a third type of liability, providing that the corporation may be held liable even if the natural person who committed the crime has not been identified. The Italian Government, however, failed to regulate this third standard of liability completely, thus probably dooming this provision to be rarely applied.

Moreover, organisational schemes play an important role when enacted *after* the commission of the offence: the implementation of such a scheme will be a crucial factor for the reduction of the pecuniary sanction (Article 12: given the focus of this paper this aspect will not be discussed in further depth), and for the exclusion or substitution of interdictive sanctions. These aspects are discussed in the following paragraphs.

Sanctions

Article 9(1) lists the sanctions that may be imposed on a corporation as a result of its conviction:

a) pecuniary sanction;

b) interdictive sanctions;

c) confiscation;

d) publication of the judgment.

Disqualification from contracting with the public administration, except to obtain the provision of public services, is listed amongst the interdictive sanctions by Article. 9(2)(c). Under Article 13(1), interdictive sanctions only apply where they are explicitly provided for in relation to an offence. The condition for the application of interdictive sanctions and the specific regulation of disqualification from contracting with the public administration will be discussed in the following paragraphs, however, it must be highlighted that the wording of Article 25 raises doubts about the applicability of interdictive sanctions - and consequently of the disqualification listed under Article 9(2)(c) - to the foreign bribery offence listed under Article 322-*bis* of the criminal code. This aspect is also discussed in the following paragraphs.

Pecuniary sanctions

A pecuniary administrative penalty is always imposed on organisations found guilty of any of the offences listed under Articles 23 and the articles that follow, and the proceeds of the crime are subject to confiscation. Under Article 25, if the crime committed by the organisation's agents is the active bribery of a foreign or domestic public officer the following pecuniary sanction shall be imposed:

- if the bribe was aimed at obtaining the performance of acts related to office, the sanction will range from EUR 25 823 to EUR 309 874 (Articles 10 and 25(1) of Legislative Decree no. 231/200110);
- if the bribe was aimed at obtaining omissions or delays of acts relating to office, or the performance of acts in breach of official duties, the sanction will range from EUR 51 646 to EUR 929 622 (Articles 10 and 25(2) of Legislative Decree no. 231/200111);
- if the second of the aforementioned types of bribe concerned the conferring of public offices or salaries or pensions or the making of contracts to which the administration employing the public officer is a party and the proceeds of the crime earned by the organisation are of a significant amount, or if the offence was committed in favour or against a party in a criminal, civil or administrative proceeding and resulted in another being wrongfully sentenced to a term of

imprisonment, the sanction will range from EUR 77 469 to EUR 1 239 496 (Articles 10 and 25(3) of Legislative Decree no 231/200112).

The actual amount of the monetary sanction will be determined mainly by the seriousness of the offence and the financial capacity of the organisation (Articles 10 and 11). Under certain extenuating circumstances the sanction will be reduced, but a minimum fine of EUR 10 329 will be imposed in all cases (Article 12),

Exclusions and disqualifications

As mentioned, the following interdictive sanctions are provided for by Article 9(2):

a) disqualification from carrying out one or more of the body's activity or activities;

b) suspension or revocation of authorisations, licences or permits instrumental to the commission of the offence;

c) disqualification from contracting with the public administration, except to obtain the provision of public services;

d) exclusion from obtaining any allowances, funding, contributions or aid, and possible revocation of those already granted.

e) prohibition from advertising goods and service.

As outlined above, those sanctions only apply where they are explicitly provided for and under the conditions listed in Article 13. In this perspective, Article 25(5) provides for the application of one or more of such sanctions to organisations whose agents committed one of the crimes listed under the paragraphs 2 and 3 of the same article (*i.e.* none of the interdictive sanctions, the disqualification from contracting with the public administration included, can be imposed for the commission of a bribe aimed at obtaining the performance of acts related to office).

In addition, Article 25(5) does not list the foreign bribery offence under Article 322-bis of the Criminal Code. A literal interpretation of this provision would make it impossible for the courts to impose disqualification from contracting with the public administration (as well as the other interdictive sanctions) on organisations convicted for that offence.

However, given the complex interrelation between Articles 318 and following of the criminal code and Article 322-*bis*[13], the foreign bribery offence(s) may be seen not as an autonomous offence but as a way of extending, under certain circumstances, the range of application of the criminal code offences pertaining to domestic bribery to acts of foreign bribery.

This opinion is confirmed, to a certain degree, by the wording of paragraph 4 of Article 25 of the Legislative Decree, that extends the applicability of the pecuniary sanctions to "the offences listed under the paragraphs 1 to 3" if "the same offences" are committed by the persons listed in Article 322-*bis*. In this line of reasoning, the reference to paragraphs 2 and 3 may be considered to include these "same offences" also when they are committed in a transnational context[14].

In this perspective, the courts could *possibly* adopt an interpretation of Article 25(5) that will allow for the application of interdicive sanctions in relation to foreign bribe offences, but only the introduction of an express statutory provision could make it certain.

The following conditions are set out by Article 13 for the application of interdictive sanctions:

a) the organisation earned a profit of significant amount from the crime and the crime was committed either by persons in a leading position or by subordinates if, in the latter case, the commission has been made possible or abetted by a serious organisational failure.

b) the organisation has already been declared administratively liable for another crime by a final decision issued in the five years previous to the commission of the last offence (Articles 13(1)(b) and 20)

If one of the conditions is satisfied (and interdictive sanctions are explicitly provided for in relation to the offence), the court is bound to impose at least one of such sanctions. In any case, the application of these sanctions is excluded if the perpetrator committed the crime predominantly serving his/her own interest or the interest of third parties *and* the offence caused exceptionally limited damage or loss (Articles 13(3) and 12(1)). Moreover, under Article 17, their application will also be excluded if the following conditions have been satisfied before the opening of the trial:

a) the organisation has given full restoration for the damage or loss caused by the offence and has eliminated all its harmful or dangerous consequences or at least has made every effort to achieve this result;

b) the organisation has enacted and effectively applied organisational schemes appropriate for the prevention of offences of the same type as the one that was committed;

c) the organisation voluntarily offered the proceeds of the offence in order to have them confiscated .

Under Article 14, the selection of the type and length of the sanction to be applied is discretionally made by the court with the aim of preventing the further commission of offences of the same kind as the one that was committed, taking into account the seriousness of the offence and the degree of blameworthiness of the organisation. The exclusion and/or disqualification will be applied to the specific business activity to which the offence committed was related. (*e.g.* corruption aimed at illegally obtaining funding will probably lead the court to impose the exclusion and revocation listed under paragraph 2(d) of Article 9)

The wording of Article 9(2)(c) gives the disqualification from contracting with the public administration a potentially very wide range of action, as the interdiction will possibly affect all types of contracts concluded with a public administration. The actual effects of the sanction imposed, however, will be specified by the court: Article 14(2) provides that the disqualification may be limited to some types of contracts or to certain administrations or agencies. Under Articles 13(2) and 25(5), a disqualification imposed for the commission of a bribe will have a term of between 1 and 2 years. Under Article 17(2), permanent disqualification from contracting with the public administration can be imposed on the organisation, if temporary disqualification has already been imposed for at least three times in the last seven years.

Under Article 78, if the organisation has satisfied the conditions listed in Article 17 (discussed above) after the opening of the trial, it may request, within 20 days from the notification of the sentence, the substitution of an additional sanction with a pecuniary sanction to be added to that already imposed.

Disqualification from contracting with the public administration imposed as a precautionary measure

To this day, the disqualification from contracting with the public administration has been applied only once, as a precautionary measure. A brief discussion of the case is provided in the following paragraphs.

On the 23 October 2003 the Judge for preliminary investigations (*Giudice per le indagini preliminari* [GIP]) of Milan received a request from the public prosecution, asking to impose a disqualification from contracting with the public administration on Siemens A.G., as a pre-trial precautionary measure.

The investigating officer produced substantial evidence, showing that three officers of the corporation had paid significant bribes to officers of ENEL Produzione and ENELPOWER and that, as a consequence of the payment, Siemens A.G. was awarded two highly lucrative contracts for the supply of a number of gas turbines to be used for the production of electricity.

It must be highlighted that the Siemens case was treated as a domestic bribery case, and does not provide further insights into the possibility of applying disqualification in relation to foreign bribe offences.

Upon that request, the judge issued a ruling that clearly sets out the requisites, under Article 45(1), that should be met to impose a precautionary measure:

a) substantial evidence against the organisation must have been produced

b) there must be a concrete danger of other offences of the same kind being committed.

Moreover, the judge expressed the opinion that one of the conditions set out by Article 13 of Legislative Decree 231/2001 (discussed above) should also be satisfied.

The first of the mentioned requisites is satisfied when: there is substantial evidence against the natural persons that allegedly committed the crime; the crime has not been committed in the offender's exclusive interest; and the alleged perpetrators can be classified either as persons acting in a leading position or subordinates under Article 5(1)(a) or 5(1)(b). In the latter case, the evidence provided must also show that the organisation failed to enact an organisational scheme or that the scheme enacted was not effective (see Article 7 discussed above). The alleged offenders were classified as subordinates, this fact leading to the applicability of Article 7.

The fact that Siemens A.G. had been keeping and probably still kept slush funds was deemed both a "concrete danger" satisfying the second requisite and a symptom of a failure of the system of controls under Article 7. The judge expressed the opinion that the mentioned circumstance showed, on the one hand, that the company considered corruption an acceptable way of conducting business and, on the other hand, that the financial operations of the company were not properly monitored.

The ruling disqualified Siemens A.G. from contracting with the public administration for a term of one year (being the maximum term under paragraph 3 of Article 51). It is noteworthy that the exact effects of the sanction were not further specified. Upon a request filed by Siemens A.G., the GIP of Milan issued a second ruling that limited the disqualification in order to affect only contracts related to the supply of gas turbines.

Article 50 provides that the precautionary measure imposed on an organisation be revoked if and when the conditions listed under Article 17 (discussed above) are satisfied.

The decisions rendered by the GIP were validated by the Tribunal of Milano on 28 October 2004.

Relevant features of the public procurement system

In addition to the disqualification pursuant to Legislative Decree 231/2001 there are other cases where a corporation involved in corruption will be excluded from participating in public procurement procedures.

Under Article 75(1)(c) of D.P.R.[15] 554/1999 (as modified by subsequent legislation) a corporation will be "excluded" from participation in procedures for the award of public works contracts if one of its directors having representative powers or its technical managers has been convicted, by a final judgment, or under Article 444 of the code of criminal procedure (Article 444 regulates the "application of the penalty upon request", a modified form of plea bargaining) for crimes affecting their "moral or professional reliability". As pointed out by the *determinazione*[16] no. 13/2003 of the *Autorità per la vigilanza sui lavori pubblici* (*i.e.* the Italian Public Works Authority), the contracting authority normally has a great degree of discretion in determining if an offence affects the "moral or professional reliability." Amongst the offences that *may* lead to an exclusion are included the "crimes against the public administration", but the contracting authority will consider the concrete characteristics of the crime committed, such as the seriousness of the conduct, the time elapsed from the conviction and recidivism. In this perspective, the implementation of Article 45(2) of the EU Directive 2004/18/EC will prevent any discretional choice in case of corruption. In any case, when the offence committed is one of those listed under Article 32-*quarter*[17] of the criminal code (as is the case with the offence listed under Article 322-*bis*) and the period of disqualification under Article 32-*ter*[18] is not elapsed, the contracting authority is bound to exclude the corporation.

Exclusion will also take place in cases of conviction of natural persons that held the relevant positions in the company in the three years prior to the publication of the contract notice, unless the corporation proves that it has taken steps or measures denoting its "complete dissociation" from the crime. The Public Works Authority pointed out that the simple substitution of the natural person(s) that committed the crime(s) would not be sufficient to avoid the exclusion. In this perspective, the contracting authority could *possibly* consider the implementation of an "organisational scheme".

As for procedures for the award of public supply contracts and public service contracts, Article 11(1)(a) of Legislative Decree 358/1992 and Article 12(1)(b) of Legislative Decree157/1995 provide for a cause of exclusion that closely matches Article 75 of D.P.R. 554/1999 (discussed above), with the exception of two relevant aspects. First, the articles make reference to a generic "applicant": according to case law, when the applicant is a corporation, the relevant convictions are those imposed on natural persons having representative powers (C.S. sez. V, 09.06.2003, n. 3241). Without any doubt Italian contracting authorities would exclude a corporation whose officers have

been convicted of a crime that "affects professional morality." It is not clear, however, whether they would exclude a corporation that has been directly convicted for such a crime. In this perspective, Article 45(2)(c) of the EU Directive 2004/18/EC, as well as Article 45(1), may have some influence on this point when it is implemented. Second, convictions imposed on natural persons who subsequently left the relevant position will not be considered: this aspect dramatically impairs effectiveness, as the corporation could easily avoid the exclusion by means of substituting or changing the role of natural persons that committed a relevant crime.

Although the provisions discussed above consider only convictions by final judgment, contracting authorities may set out stricter requirements in the contract notice: the practice of requesting the *certificato dei carichi pendenti* (a certificate that shows if a natural person has been indicted for a crime) of the natural persons holding relevant positions in the corporation is fairly widespread. However, only an explicit statutory provision would guarantee a sufficient degree of uniformity.

The corporation must prove its suitability as an applicant and the absence of a cause of exclusion by producing either a certificate issued by the competent administration or a substitutive formal declaration (submitting a false declaration would constitute a criminal offence). The contracting authority must verify the declaration submitted by the applicant that was awarded the contract.

Information on the more relevant steps of public procurement procedures is published in official journals and bulletins at European, national, or local level, depending on the relevance of the contract to be awarded.

As far as public works contracts are concerned, Article. 4 of the law no. 109/194 established the Public Works Authority, that monitors the compliance with statutory and regulatory rules and, specifically, the legality of the procedures for the award of public works contracts, Article 4(3)(b), among other duties. Pursuant to Article 27 of D.P.R. no. 34/2000, the Authority administers an electronic database of relevant information that contracting authorities may use in order to find out if an applicant should be excluded.

As for procedures for the award of public supply contracts and public service contracts, Article 26 of Law no. 488/1999 and the implementing regulation established Consip s.p.a., a state controlled company, that acts as a central contracting authority for the conclusion of framework agreements. Consip s.p.a has competence for contracts of (at least) national relevance. The conclusion of framework agreements is also encouraged at regional and local level.

This distinct trend towards centralisation will enhance the overall effectiveness of both the exclusions described above and the disqualification under Legislative Decree 231/2001.

Concerning administrative sanctions imposed on corporations pursuant to Legislative Decree 231/2001, Article 80 established an *anagrafe nazionale delle sanzione amministrative* (an official record of the sanctions imposed on the corporation). Under Article 32 of D.P.R. 313/2002 public administrations can obtain a certificate showing all the records of a corporation. Moreover, it has become a common practice for contracting authorities to ask applicants (under threat of exclusion) to produce a certificate of the *anagrafe* or a substitutive declaration.

Conclusions

Although the relevant statutes were enacted in 2001, case law has been developing very slowly: the only definitive sanctions imposed pursuant to Legislative Decree 231/2001 are the result of plea bargaining and are of a pecuniary nature. Therefore, given that further statistical information is not available, an assessment of the effectiveness of the disqualification from contracting with the public administration as a tool for fighting corruption cannot be based upon empirical data.

As a general rule, it is difficult to impose monetary sanctions on corporations effectively. Usually these sanctions can be easily absorbed by the corporation as a business cost. On the other hand, the corporation may not have the financial capacity to pay a very high fine. In any case, if the profit that the corporation earned from the crime is not *completely* confiscated (courts may face great difficulties in determining its actual amount), the illegal gain that is left in the hands of the company will "neutralise" at least a portion of the fine, thus misleading the court in its quantification. Moreover, as far as Legislative Decree 231/2001 is concerned, the maximum amount of the fine is probably too little to affect the biggest and wealthiest companies significantly.

In this perspective, restrictions of entrepreneurial liberty are probably necessary elements of an effective system of corporate liability. The Italian legislature adopted a flexible approach, by establishing a complex system of incentives and sanctions in order to induce or force corporations into compliance and prevent recidivism. Given this legal framework, the overall effectiveness of the system will be dramatically influenced by the interpretation that the courts will give of the provisions that play a central role in determining the standards of liability, the selection of the sanction(s) to be imposed, and the conditions under which a corporation will be offered the chance of avoiding the sanction by bringing its practices into full compliance with the law.

Given the wording of Article 9(2)(c), the actual effects of disqualification will be highly variable, as it may affect one or more products, contracts, etc. Moreover, corporations will not always be affected in the same way: imposing disqualification from participation in public procurements on a highly specialised company may possibly lead to its financial ruin, while the sanction imposed on Siemens A.G. only affected one of its fourteen divisions. In this perspective, the Italian legislature tries to strike a balance between statutory guidance and judicial discretion, giving the courts the power to "fine tune" the disqualification and make it fit the characteristics of both the offence and the corporation. In order for this fine tuning to take place, the courts will have to thoroughly examine the corporation and fully understand its structure and inner mechanisms, as well as its market position; obviously not an easy task.

While an effective response to corruption requires, among other conditions, a legal framework providing a full range of sanctions for individual and corporations alike, disqualification from participation in public procurement will probably play an important role within that framework.

Notes

1 G. Sacerdoti. Responsabilità d'impresa e strumenti internazionali anticorruzione - Dalla Convenzione OCSE 1997 al Decreto n°231/2001.

2 A Legislative Decree is a form of delegated legislation that has the same effects as legislation enacted by the Parliament.

3 E. Musco, Le imprese a scuola di responsabilitàtra pene pecuniarie e misure interdittive, in Dir. e Giust., n. 23, 8

4 Alessandri, Riflessioni penalistiche sulla nuova disciplina, in A. Alessandri, H. Belluta et al., La Responsabilità amministrativa degli enti. D.lgs. 8 giugno 2001, n. 231, ipsoa 2002, 25, at 45 ff

5 G. De Simone, I profili sostanziali della responsabilità c.d. amministrativa degli enti: la "parte generale" e la "parte speciale" del d.lgs. 8 giugno 2001 n. 231, in G. Garuti (Ed.), Responsabilità degli enti per illeciti amministrativi dipendenti da reato, cedam 2002, 57 at 83 ff

6 The interpretation given in the Commentaries is not binding.

7 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428

8 C. E. Paliero, *Il d.lgs. 8 giugno 2001, n. 231: da ora in poi* societas delinquere (et puniri) potest, in *Corr. giur*, n. 7/2001, 845

9 C. E. Paliero, *Il d.lgs. 8 giugno 2001, n. 231: da ora in poi* societas delinquere (et puniri) potest, in *Corr. giur*, n. 7/2001, 845

10 An overview of the mentioned offences in the English language appears in the phase 1 national report on the implementation of the OECD anti-bribe convention in Italy. The report is posted on the OECD Web site at the following address: http://www.oecd.org/dataoecd/39/61/2019055.pdf

11 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428

12 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428

13 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428

14 G. De Simone (fn 3) at 121 ff

15 *Decreto del Presidente della Repubblica* (D.P.R.) is a regulation adopted by the Government and formally issued by the President of the Republic.

16 A *determinizione* is a directive issued by the Italian Public Works Authority that provides guidance to the contracting authorities.

17 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428 at 17

18 D. Pulitanò, La responsabilità "da reato" degli enti: i criteri di imputazione, in Riv. it. dir. proc. pen., 2002, 428

Chapter 32

The Challenges Facing Debarment and the European Union Public Procurement Directive

by

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I. Aims and Structure

This paper identifies some of the challenges facing debarment, primarily by exploring the practical implications of the new European Directive on public procurement, as well as on the basis of empirical evidence of other debarring processes.

The paper is structured as follows:

- Section II sets out the rationale for debarment;
- Section III identifies different types of debarment processes;
- Section IV explores the challenges to debarment raised by the new European Public Procurement Directives;
- Section V sets out challenges identified in the context of other debarring processes.

II. Rationale for debarment

The main argument in favour of adopting debarring policies is economic. The aim of debarment is to deter companies from paying bribes by increasing the costs of bribery, so introducing a strong economic disincentive.

The payment of a fine by the company is the most common penalty incurred in the majority of bribery cases involving large companies. Employees may also be fired or sent to prison. None of these sanctions offsets the economic benefits that are likely to arise from the payment of bribes to gain improper business advantage.

III. Types of debarment processes

Examples of debarring cases and debarring legislation are provided in the following table. These are categorised according to whether the process is judicial (involving the courts) or administrative (part of the procurement procedure) in nature.

In principle, the most effective is a rigorous administrative system, with sufficient checks and balances, which is independent of time-consuming criminal investigations involving the courts.

Table 32.1. Selected debarment cases/processes

description	type
Singapore, 1996. In February 1996, Japan's Tomen Corp. and Marubeni Corp., Germany's Siemens AG, Britain's BICC Cables plc and Italy's Pirelli Cables, along with some subsidiaries, were debarred from Singapore government contracts. "Appeal in cases involving corruption is normally not allowed," the ministry said. The ban stretched from January 27, 1996 to January 26, 2001. A consultant working for the firms allegedly gave bribes to the Public Utilities Board Deputy Chief Executive, in exchange for confidential information on public tenders.[1]	administrative
Slovakia, 2002. In April 2002, it was reported that Germany's Siemens Business Services (SBS) had successfully appealed against its exclusion from a tender to provide IT for the Slovak Treasury. The Slovak Finance Ministry had excluded Siemens from the bidding four times, but was then required to include SBS's bid in its assessment. Representatives of Siemens were alleged to have offered the commission chairman SKK 1.5 million to convince other commission members to choose the German firm. A Siemen's representative was charged with bribery.[2]	administrative
Italy, 2004. In April 2004 an Italian judge barred German electronics group Siemens AG from conducting business relations with Italian public administration bodies for the period of one year.[3] The decision was taken in the framework of the investigation on suspected cases of corruption involving Siemens and Italy's Enelpower, a unit of local energy group Enel. Later in May 2004, Siemens reported that a judge's order banning it from dealing with Italy's state-owned firms and public bodies had been amended to apply only to gas turbines.[4]	judicial
The World Bank, 1998-2004. In 1998 the World Bank put in place new procedures for debarring contractors from future Bank-financed contracts if it were found that the contractors committed fraud or corruption in the procurement or execution of Bank-financed contracts. In July 2004, the World Bank sanctioned Acres International, one of Canada's leading construction management and engineering consultancies, following its conviction for corrupt activities in the Bank-financed Lesotho Highlands Water Project. Acres has been declared ineligible to receive any World Bank contracts for three years. This is the *only* example of a large multinational company being debarred by the Bank. The list of c200 debarred companies and individuals, is otherwise dominated by small companies.[5]	administrative
The European Commission. The European Commission's new public procurement Directives were adopted on 3rd February 2004 by the European Union's Council of Ministers and the European Parliament.[6] Article 45 contains a new provision for the mandatory exclusion of candidates for participation in a criminal organisation, corruption, fraud or money laundering (see Box 32.1.). Contracting authorities must exclude candidates 'if they are aware' of such convictions. It requires member states to assign 'competent authorities' to supply contracting authorities with the relevant information about such convictions.	judicial

IV. Challenges raised by the EU public procurement directive

Article 45 potentially represents a major step forward in curbing corruption. The threat of being excluded from tendering for public procurement contracts across the EU, significantly increases the costs of corruption, thus introducing economic disincentive to engage in bribery. Its actual impact will depend on the strength of implementation by the member states and the harmonisation of implementation across the EU.

Box 32.1. Excerpts of Directive 2004/18/EC on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts *

Section 2
Criteria for qualitative selection
Article 45

Personal situation of the candidate or tenderer

MANDATORY

1. Any candidate or tenderer who has been the subject of a conviction by final judgment of which the **contracting authority is aware** for one or more of the reasons listed below **shall be excluded** from participation in a public contract:

   (a) participation in a criminal organisation, as defined in Article 2(1) of Council Joint Action 98/733/JHA (1);

   (b) corruption, as defined in Article 3 of the Council Act of 26 May 1997 (2) and Article 3(1) of Council Joint Action 98/742/JHA (3) respectively;

   (c) fraud within the meaning of Article 1 of the Convention relating to the protection of the financial interests of the European Communities (4);

   (d) money laundering, as defined in Article 1 of Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering (5).

Member States shall specify, in accordance with their national law and having regard for Community law, the implementing conditions for this paragraph.

EXCEPTIONS

They may provide for a derogation from the requirement referred to in the first subparagraph for overriding requirements in the general interest.

INFORMATION FIRST FROM THE TENDERER AND THEN FROM COMPETENT AUTHORITY

For the purposes of this paragraph, the contracting authorities shall, where appropriate, ask candidates or tenderers to supply the documents referred to in paragraph 3 and may, where they have doubts concerning the personal situation of such candidates or tenderers, also apply to the competent authorities to obtain any information they consider necessary on the personal situation of the candidates or tenderers concerned. Where the information concerns a candidate or tenderer established in a State other than that of the contracting authority, the contracting authority may seek the cooperation of the competent authorities. Having regard for the national laws of the Member State where the candidates or tenderers are established, such requests shall relate to legal and/or natural persons, including, if appropriate, company directors and any person having powers of representation, decision or control in respect of the candidate or tenderer…

PROOF

> …(a) as regards paragraphs 1 and 2(a), (b) and (c), the production of an extract from the 'judicial record' or, failing that, of an equivalent document issued by a competent judicial or administrative authority in the country of origin or the country whence that person comes showing that these requirements have been met;
>
> (b) as regards paragraph 2(e) and (f), a certificate issued by the competent authority in the Member State concerned.

Where the country in question does not issue such documents or certificates, or where these do not cover all the cases specified in paragraphs 1 and 2(a), (b) and (c), they may be replaced by a declaration on oath or, in Member States where there is no provision for declarations on oath, by a solemn declaration made by the person concerned before a competent judicial or administrative authority, a notary or a competent professional or trade body, in the country of origin or in the country whence that person comes.

4. Member States shall designate the authorities and bodies competent to issue the documents, certificates or declarations referred to in paragraph 3 and shall inform the Commission thereof. Such notification shall be without prejudice to data protection law.[7]

*Emphasis and sub-headings have been added.

Information exchange

The success of Article 45 depends on contracting authorities being *aware* of corruption convictions, which in turn relies on flows of information to public authorities both within and between member states.

Article 45 does not make any provisions for a general information exchange system. Rather, it relies on contracting authorities asking suppliers to confirm whether or not they have been found guilty of corruption, *inter alia,* and in cases of suspicion only, contacting a designated competent body in order to gather more information.

This system suffers from a number of weaknesses:

- a complete lack of transparency;
- the assumption of a competent body which compiles information on corruption cases. This is not the case in many countries. In the UK, for example, there is no single database that isolates corruption cases.8 The Attorney General is required to give his/her consent for the prosecution of any corruption case, but currently does not compile this information;
- partiality: there is no means to ensure consistent implementation and no provisions for gathering information on convictions of EU companies in non-EU (third) countries or on the corruption convictions of companies from non-EU (third) countries;
- potential conflicts of interest and thus a disincentive on the part of the member state to divulge information which will prevent its national companies from tendering from public procurement tenders in other member states;
- there is a number of practical difficulties including language and the willingness of member states to provide a speedy response.

An EU-led system would provide a better solution. This could involve either the compilation of an EU-wide register of corruption convictions or the requirement for member states to post details of corruption convictions on public web sites.

Such a system is however highly controversial.

Box 32.2 Reasons against an EU-wide blacklist

- Data protection issues associated with the exchange of criminal data (what information, how long is it held, what right of appeal)
- The need for a legal system to underpin the passing of information on criminal records from one member state to another (No such basis currently exists.)
- The fact that exchange of criminal records between member states as an issue reaches far beyond public procurement and cannot be decided in relation to the needs of Article 45
- The ability of those blacklisted companies to work behind "fronts" or "men of straw" [9]

Linking natural and legal persons

The Directives make no reference to the conditions under which conviction of a natural person responsible for or managing an economic operator shall be deemed equivalent to conviction of that economic operator were it to have legal personality. This has been left to the member states.

In the UK, even though in principle legal persons can be convicted for corruption, the need to prove that there is a 'controlling mind' means that in practice employees rather than companies will be prosecuted. In the UK there have been no prosecutions of companies for corruption to date and this is likely to remain the case in the near future. This makes this issue highly pertinent.

In the World Bank's administrative system, in the case of a debarred individual, "ineligibility extends to any firm which the debarred individual directly or indirectly controls."[10]

Time between conviction and disqualification from tendering/debarring period

There is no guidance provided on the period of time between the date of conviction and disqualification. The Commission's original text stated that "any economic operator shall be excluded from participation in the contract who at any time during a five-year period preceding the start of the contract award procedure, has been convicted by definitive judgment"

However, this provision is not in the final text and is likely to result in varying practices across the EU.

An EU study on public procurement and organised crime[11] found that there is no consistency on the period of time for exclusion. Some member states only allow exclusion from the current tender (Austria, Denmark, Finland, Ireland, the United Kingdom, the Netherlands and Sweden); others allowed for indefinite exclusion (France, Greece and Italy); whilst others for a set period of time (Belgium, Germany, Portugal, Spain and Luxembourg) but varying, for example, from 3-10 years in the case of Belgium to five years or less in the case of Spain.

Limited responsibility of the tendering authorities

The contracting authority is required to act only if it "is aware" of the conviction. There is no expectation that the contracting authority will be proactive/or investigative or even consult the World Bank's list of debarred companies.

Basis for assessing compliance

There is no guidance available on the tests/sanctions to be applied on whether tendering authorities had made a reasonable effort to comply and what to do if they had not.

Piercing the corporate veil

Article 45 requires contracting authorities to ask suppliers to confirm that they have no convictions. It provides no guidance on how to 'pierce the corporate veil': *i.e.* whether the supplier should provide information on convictions involving parents or subsidiaries.

In the World Bank's administrative debarment process "in the case of a debarred firm, ineligibility extends to any firm or individual which directly or indirectly controls the debarred firm or any firm which the debarred firm directly or indirectly controls."[12]

However in the case of Acres, ineligibility extends to any firm directly or indirectly controlled by Acres International Limited, but does not extend to any firm or individual that directly or indirectly controls Acres International Limited: "…the ineligibility of the debarred firm does not extend to its sister corporations, including Acres International Corporation, Acres Management Consulting, and Synexus Global Inc."

Sub-contractors

Article 45 makes no reference to sub-contractors, although Article 25 provides for tenderers to ask for information on sub-contractors.

> *In the contract documents, the contracting authority may ask or may be required by a Member State to ask the tenderer to indicate in his tender any share of the contract he may intend to subcontract to third parties and any proposed subcontractors. This indication shall be without prejudice to the question of the principal economic operator's liability.*

Assessing risk

The Directive is confined to convictions. It does not ask tendering authorities to take account of allegations or investigations of corruption which may result in suppliers being convicted after they have been contracted.

Corrupt suppliers

There is no guidance on what to do in the case of a current supplier being convicted or in the case of a corruption conviction coming to light after a contract has been awarded.

Avoiding conflicts of interest

There is likely to be a conflict of interest between the efficiency of the procurement process and the decision to exclude companies for corruption. This needs to be accounted for in the assigning of powers and responsibility in the procurement process.

V. Other debarment challenges

Appeals: getting the balance right

In the case of Singapore's debarring of 5 OECD multinationals back in 1996 there was no provision for appeal.

> *BICC, the world's second largest cable manufacturer, has lodged an appeal with the Singapore finance ministry over a five-year ban on tendering for government power contracts. The ban was imposed this week after five international manufacturing and contracting companies were implicated in a bribery scandal. Singapore's finance ministry said yesterday that appeals in cases involving corruption were 'normally not allowed.*[13]

In the case of Siemens' debarment in Milan, a month after the Milan magistrate's ruling to the Court of Cassation that Siemens was to be banned for one year from public contracts Siemens announced that the ban applied only to gas turbines. It also successfully overturned exclusion from a bid in Slovakia (see Table 32.1. Selected Debarment Cases/Processes).[14]

Lack of political will

There is evidence to suggest that there is a lack of political will associated with debarment, especially with respect to large companies.

A report by Multinational Monitor[15] argues that large contractors enjoy an unfair advantage over smaller contractors in the United States' suspension and debarment system. As is the case in World Bank debarment, action is most commonly taken against small contractors.

According to research carried out by the Project on Government Oversight, only one of the top 10 repeat offenders has been debarred (General Electric):

- General Electric, with 63 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements and clean-up costs totalling USD 982 859 555;
- Lockheed Martin with 63 instances of misconduct/alleged misconduct and USD 231 872 404 in payments;
- Boeing, with 36 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 357 973 000;
- Raytheon, with 24 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 128 652 919;
- Northrop Grumman, with 21 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 87 876 581;

- Fluor, with 19 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 70 016 614;
- United Technologies, with 18 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 214 836 860;
- TRW, with 16 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements and totalling USD 389 484 000;
- AT&T, with 14 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 16 090 000;
- Unisys, with 12 instances of misconduct and alleged misconduct and fines, penalties, restitution, settlements totalling USD 182 245 692 in payments.[16]

The report argues that there is a lack of political will to debar large companies in some cases because the government is dependent on key suppliers.

Lobbying by business

Company lobbying can be highly effective in diluting the strength of debarment provisions or sanctions or even revoking laws.

In 2000 in the UK, the Export Credit Guarantee Department (ECGD) first announced that it would exclude companies with corruption convictions from insurance cover. This was a response to the findings of UK's House of Commons' International Development Select Committee, which called for "black-listing" of UK firms found *guilty of corrupt* practices.

Then, driven partly by activities of campaigning NGOs such as Cornerhouse, ECA-Watch and Transparency International, the ECGD announced that it was bringing in a raft of new anti-corruption measures commencing May 1st 2004 to strengthen "*…procedures to minimise the risk of bribery and corruption on business deals supported by the Export Credits Guarantee Department (ECGD*)".[17]

Then in November 2004, the ECGD announced that it was backtracking on five main anti-corruption provisions including the requirements to guarantee that "*…their affiliates or joint venture partners are not involved in bribery*" and that "*employees should have no record of corrupt practices*."

Rolls-Royce, the Airbus Consortium and BAE Systems were named by John Weiss, deputy director of the Export Credit Guarantee Department, as the main objectors to rules which came into force last May and are to be watered down from next month.[18]

In the USA in 2002 it seems that corporate lobbying led Bush to revoke the so-called 'Blacklisting' Rule.

Notes

1 FT, Reuters [2/16/1996] “Singapore blacklists scandal-tinged firms”, World Trade News: Financial Times [2/16/1996] 'BICC appeals over contracts ban - Singapore penalises five foreign companies caught up in bribes scandal:' by Tim Burt and Wolfgang Munchau Frankfurt

2 Czech Republic and Slovakia Business Report [5/19/2002] 'Siemens wins bid to return to treasury it tender' [Source ID = 6711] ; Czech News Agency [4/17/2002] 'Siemens to return to tender for it for slovak treasury' [Source ID = 6712] ; Associated Press AP Worldstream [10/10/2001] 'Unidentified Slovak Siemens official faces corruption charges' [Source ID = 6714] ; Associated Press [8/10/2001] 'Prosecutor orders investigation of allegations that Siemens representative tried to bribe official' [Source ID = 6715]

3 ANSA English Corporate Service, 28/04/2004, Judge Bars Siemens AG from Business with Italy Public Bodies

4 The Times, 06/05/2004 ‘Siemens order amended’

5 http://web.worldbank.org/external/default/main?theSitePK=84266&content MDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984

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7 http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_134/l_13420040430en01140240.pdf.

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9 Interviews held with representatives of the European Commission in July 2001

10 http://web.worldbank.org/external/default/main?theSitePK=84266&content MDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984

11 S. White (ed.), Procurement and Organised Crime. An EU-wide study, London, Institute for Advanced Legal Studies, 2000

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13 World Trade News: Financial Times 16/02/1996

14 Copyright 2004 Times Newspapers Limited, The Times (London), May 6, 2004, Thursday.

15 Dormant Power of the Purse The Failure of the Government to Use its Purchasing Power to Promote Corporate Compliance with the Law http://multinationalmonitor.org/mm2002/02july-aug/july-aug02corp5.html

16 http://www.pogo.org/p/contracts/co-020505-contractors.html.

17 http://www.ecgd.gov.uk/news_home.htm?id=6095

18 The Guardian Bribery rules too tough for Rolls, Airbus and BAE, David Hencke and Terry Macalister, Wednesday November 17, 2004

Chapter 33

Ensuring Compliance with Anticorruption Laws Through Sanctioning or Voluntary Self-Regulation

by

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Public procurement globally involves huge amounts of money. Not surprisingly, it attracts many criminals who try to channel parts of this money into their own pockets. These criminals are among the officials who award and supervise contracts, the individuals and companies who seek to obtain contracts for themselves or act as agents for others, and those who execute such contracts. In cases of corruption, there is usually collusion among them.

Therefore, any efforts to develop laws, rules, regulations and structures to ensure compliance with anti-corruption laws and thus to minimise corruption and its adverse consequences must address both the side of the public office (a government department or public agency, here called the "principal") as well as the side of the bidder or contractor, whether consultant, supplier or civil works contractor. On both sides there must be measures for prevention and for sanction.

Measures applicable to the principal

On the side of the principal, there should be a clear set of procurement rules, a code of conduct, adequate preventive measures (such as sufficient transparency of the process, separation of functions, "four eyes principle", rotation of officials), regular training and awareness-raising activities for officials and adequate sanctions. The sanctions should range from disciplinary to civil and criminal and they should include confiscation of all ill-gotten gains. Sanctions must be enforced if violations occur. Otherwise sanctions become useless and ineffective.

Measures applicable to the bidder or contractor

On the side of the bidder or contractor it would also be desirable to have codes of conduct in place, in addition to effective compliance programmes. Unilateral integrity pledges by individual bidders or mutual commitments by members of an industry or sector group to integrity-based market behaviour are more recent instruments in the international effort to reduce corruption. If corrupt activities are nevertheless discovered, there is criminal prosecution. But the principal usually also has several other sanctions available – such as denial/loss of the contract, forfeiture of any bid or performance bonds, liability for damages and debarment for future contracts.

In this context it is necessary to acknowledge that many countries (including Germany) have not yet adopted the concept of criminal liability of legal persons. Thus companies have little to fear other than the prosecution of individual members of the management or staff, except debarment.

Liability for damages

While it is normally the principal who can make a claim for damages, should the case arise, there are good reasons why competing bidders can also make a claim for damages. The preparation of bids or proposals often is quite costly (and may have been in vain, if the award of the contract is determined by corruption). In view of the fact that the determination of the size of the damages may be complicated, stipulating a pre-agreed amount of damages to be paid ("liquidated damages" or a "pre-determined contract violation penalty") has proven to be effective, especially if the agreement includes a proviso that the principal or contractor can claim a larger or smaller amount if they can offer sufficient evidence.

Debarment

Debarment of a corrupt bidder or contractor from future contracts turned out to be a particularly effective sanction and thus a deterrent to corruption. It has been practised by the World Bank for several years now and has been applied in a number of jurisdictions (including the European Commission) with varying degrees of consistency and success. The experience with debarment - or blacklisting - in Germany is the specific focus of this presentation. Before coming to that, a few words about another potential approach to the selection of contractors, that is whitelisting.

Whitelisting

Whitelisting is a potential approach to the selection of contractors. It is a form of pre-qualification where bidders must meet certain criteria to be added to a list, and only companies on that list will be invited to participate in bidding (or other more restricted selection events). Under standard pre-qualification procedures (*e.g.* in the selection of civil works contractors for large projects) the criteria relate primarily to financial and technical competence. For a whitelist designed to reduce corruption one would add integrity criteria. The criteria for pre-qualification may include previous convictions of, or involvement with corruption-related crimes and the existence of internal corruption prevention and control instruments such as codes of conduct and other safeguards against corruption. Whitelisting cannot substitute for the debarment of a company that has committed corruption in an actual bidding process, unless the company found to be corrupt is promptly removed from the whitelist. To be effective, a whitelist would have to be totally transparent and fully accessible to the public. Otherwise the risk of manipulation would be too high.

Voluntary self-regulation

Voluntary self-regulation measures can be undertaken both by principals and by bidders or contractors. Voluntary self-regulation efforts are becoming a common feature among many private companies worldwide, especially in companies operating globally. Measures usually take the form of a code of conduct and a compliance programme, which the company issues for (and preferably jointly with) its employees. Many models are available today. For example, the Business Principles for Countering Bribery, developed by Transparency International together with Social Accountability International and a dozen global companies, have been tested extensively by several of these companies. However, one-sided commitments without adequate sanctions are not likely to be fully effective.

Sector agreement

Another approach is a sector agreement. The Business Principles for Countering Bribery in the Engineering and Construction Industry were recently adopted by some members of the international engineering and construction industry. Agreements are being developed by other industry sectors as well, including the arms, oil and pharmaceutical industries. The principles, developed with assistance from Transparency International, were agreed upon at the 2004 World Economic Forum in Davos. Under this approach signatory companies commit themselves to certain rules of market behaviour. For instance, this may include a zero tolerance policy on bribery and the development of

practical and effective internal programmes for implementing the policy. While such sector agreements do not yet contain mutual monitoring and sanctioning provisions, the signatories expect peer pressure to be effective in promoting compliance with the agreement. Such sector agreements may in time achieve major significance in reducing corruption, after sufficient (and sufficiently large) members of a sector have subscribed to them. An earlier effort to develop a sector agreement by members of the construction industry in Bavaria, which even included a certification element, has not become relevant beyond the borders of Bavaria.

Integrity pacts

Yet another instrument, also developed by Transparency International, is the integrity pact. Under an integrity pact, a principal and all the bidders for an investment project mutually commit to refrain from and prevent all corrupt acts and submit to effective sanctions in the case of violations. Bidders also disclose all payments to agents or any other third parties in connection with the contract in question, responding to the global experience that independent agents or other intermediaries are frequently used by exporting companies to obtain contracts in ways that they hope do not reflect adversely on the exporting company itself. Integrity pacts have been used successfully in a number of countries, including Mexico and Korea. An integrity pact is also just being introduced in the major international airport project in Berlin-Schönefeld.

Experience with debarment or blacklisting in Germany

German public procurement regulations (Verdingungsordnung für Bauleistungen (VOB) and Verdingungsordnung für Leistungen (VOL) provide for the possibility of excluding a bidder from participating in a bidding process on the grounds of "unreliability." In such a case, the bidder needs to have demonstrated "unreliability" in certain ways, for example, by committing a "serious infraction." But this option is rarely used because the concept of "unreliability" and "serious infraction" is vague and their presence is difficult to establish. They would have to be established by the principal of a new bidding process, who usually knows nothing about the prior behaviour of the bidder, unless there is something on the public record. For those reasons, several of the Bundesländer have worked with varying forms of debarment registers. The debarment decision is still made by one principal (government department or agency) based on its own experience with that bidder. That decision is then made available to other principals who award public contracts through a list or register, which may have optional or mandatory character. Registers exist today in Baden-Württemberg, Bremen, Hamburg, Hessen, Niedersachsen, Nordrhein-Westfalen, Rheinland-Pfalz and Schleswig-Holstein. The federal government has considered introducing a central register for some time, and has taken several ill-fated initiatives. In a recent draft bill (October 2004), the Government reiterated its commitment to establish such a central debarment register as part of a major reform of the procurement laws and rules.

Under the debarment concept, a corrupt company or individual would be debarred by one public principal and thereafter listed in a register, the blacklist, and thus be made ineligible for the award of contracts by other principals as well, or at least be subject to particular scrutiny while on the list. The major questions to be addressed here are the following: What are the preconditions for the debarment and blacklisting? Who takes the decision to debar and blacklist, and how long is debarment effective? What are the

consequences? Is access to the register public or restricted? How does the listed company get off the blacklist?

Regarding the preconditions, existing laws in Germany vary somewhat but usually require something like that "in view of the evidence available there is an adequate basis for the assumption of a corrupt act and no reasonable doubt about it exists." Admission of guilt or confession by one of the perpetrators, or refusal to deny the accusation, would make a strong case.

A very recent bill for a new anti-corruption law in Nordrhein-Westfalen, where a debarment register has already been in operation for several years allows debarment and entry into the register in a number of situations. These situations are (i) when a criminal court has opened proceedings under specified anticorruption laws; or (ii) a criminal conviction has occurred; or (iii) an order of summary punishment has been issued; or (iv) a criminal prosecution has been closed on grounds of insignificance; or (v) a fine has been imposed; or (vi) after criminal or administrative fine proceedings have been started, if on the basis of the evidence available no reasonable doubt exists that a serious violation has occurred.

Occasionally it is argued that only a final conviction in a court of law can lead to debarment. If debarment were limited only to individuals who have been finally convicted of corruption by a criminal court (*res judicata*), this would obviously be a "safe" course. However, it would also render the whole concept ineffective. Very few corruption cases lead to final convictions. When there are final convictions, they usually occur after many years, when any impact of debarment would be lost. Because criminal liability of legal persons does not exist in Germany, companies could not be blacklisted under such narrow preconditions. However, blacklisting a company or an individual on the basis of mere suspicion would be equally unacceptable. Thus a middle position that respects the rule of law and yet provides an effective warning to potentially corrupt individuals and companies had to be found. After all, debarment is not a criminal sanction but an administrative sanction and thus does not need to be subjected to the stricter requirements of a criminal process.

The decision to debar an individual or a company is made by the principal under whose project the corrupt act took place. One would also expect the appropriate legal services to be involved in those decisions. Any debarment decision (with all the relevant information) must be reported to the register and the individual or company will be listed. The person or company to be debarred must be informed beforehand and given the opportunity to comment on the findings and decision and explain why the debarment should not take place.

The debarment rules in Germany do not provide explicitly for an appeals process, but the debarment and listing can be challenged in court.

Debarment and listing are effective for a specified period of time, or without a time limit. The time period, when specified is normally between one and five years, reflecting the severity of the corrupt act. The severity would be judged by taking into account factors such as the amount of the damage done by the corruption, the involvement of senior managers *versus* junior staff, whether it is a recurrence of corruption, and whether the principal or staff share responsibility.

The consequences of a listing decision are that all "principals" within the jurisdiction of the register are under obligation to consult the register before awarding a contract above a fairly low value threshold and to refrain from contracting with debarred

individuals or companies. In exceptional circumstances principals may contract with such parties anyway, but those exceptions must be justified on the record.

One of the current problems in Germany is that, to date, consulting the registers or lists operated by the Bundesländer is mandatory only for procurement officials acting on behalf of the Bundesland in question. In a few cases, municipal or other procurement officials have the option, but not the obligation, to consult the register, even though the aggregate value of the contracts they award may be significantly higher than contracts awarded by Bundesland officials.

In response to this problem, Transparency International (TI) has been demanding a central federal register that would be mandatory and binding for all federal, Bundesland and municipal procurement officials. Such a register is presently under discussion.

A major issue, which is still unresolved, is whether to make such registers accessible to the public or to restrict access to procurement officials. Presently existing rules generally restrict access to procurement officials on the grounds that access to competitors and the public at large could cause additional damage to the listed companies.

TI's position is that such registers should be freely accessible to the general public to prevent mismanagement or manipulation of the information by corrupt officials. It is worth noting here that the World Bank posts its debarment list on its Web site.

Normally the listing automatically lapses when the specified period expires. But several Bundesländer allow for an earlier cancellation of the listing under the condition that the individual or company has demonstrated that it has taken adequate structural or organisational measures to prevent a recurrence of the violation; that it has paid off the damages; and in some cases, that it has terminated or otherwise disciplined the individual(s) who committed the corrupt act.

It is interesting to note that a civil court in Germany, the Landgericht Frankfurt/Main, recently declared valid and effective a debarment decision by the Deutsche Bahn, a former state-owned enterprise which is now privatised. The arguments would equally apply to debarment by a public institution.

There is, and perhaps can be, no hard evidence about the positive impact of debarment and blacklisting. Based on conversations with representatives of national and international companies, it is perfectly clear, however, that the risk of being debarred, especially by major governments or public agencies, is a significant deterrent to corruption. TI considers it highly desirable that national debarment systems are developed and eventually pooled across borders.

Chapter 34

The Korean Public Procurement Service Integrity Pact

Introduction

Since corruption in government procurement can result in the poor implementation of contracts and cause enormous waste in terms of government budgets, measures to counteract corruption are essential. Generalised systems to reduce corruption that are in line with international anti-corruption endeavours, including the OECD Anti-Bribery Convention and the Integrity Pact developed by Transparency International, need to be introduced. In order to prevent corruption throughout the process of establishing and implementing government contracts, a means of punishment for the breach of integrity agreements must be ensured.

The Korean Public Procurement Service (PPS) has implemented an Integrity Pact for all contracts since 1 March 2001. The purpose of this pact is to illustrate to the private sector the fact that business values originate from business ethics and to encourage them to join the campaign against corruption. This pact requires businesses and contract officials to pledge that they will not solicit or provide gratuities or entertainment with regard to procurement. A survey of this pact is conducted twice a year and then the results are published.

Application of the Integrity Pact

Scope of application

The Integrity Pact is applied to all construction, goods and services contracts executed by the PPS.

Methods of application

The special bidding instructions of the Integrity Pact are attached to the bidding invitation. Specific terms and conditions of the Integrity Pact are attached when establishing the contract.

Special bidding instructions of the Integrity Pact

Obligations of integrity are stipulated for all contracting companies with regard to public procurement procedures in the Special bidding instructions of the Integrity Pact (Annex 34.A.). The main contents of the Special Bidding Instructions are as follows:

- The awardee is required to submit the Integrity Pledge for Contracting Companies (Annex 34.B.) as part of contract conditions. If the awardee does not submit the Pledge within 10 days after notice of the award, the award will be cancelled.
- Any violation of the Integrity Pact will entail penalties, including debarment for six months to two years, cancellation of the award, and cancellation or termination of the contract.
- Contracting officials are required to submit an Integrity Pledge for Public Officials (Annex 34.C.) to the head of the public procurement contract division. Any violation of integrity obligations will mean the imposition of sanctions.

Specific terms and conditions of the Integrity Pact

The Specific Terms and Conditions of the Integrity Pact (Annex 34.D.) establish the special rules of integrity (other than the general contract rules regarding the contracting of goods services and construction) between a PPS official in charge of contracts and a contractor. The Terms outline contractors' obligations for integrity throughout the procurement process, and sanctions for the violation of such obligation.

Integrity pledge for contracting companies

By signing the Integrity Pledge for contracting companies (Annex 34.B.), contracting companies pledge not to provide any grants or entertainment throughout the process of bidding, awards, contract establishment or implementation. Penalties for violation include the following:

- In the case that the contract has not yet been established, violators will be excluded from the list of eligible awardees. An award to any awardee who has violated the Pledge will be cancelled.
- In the case that the contract has been established but construction has not yet begun, the contract will be cancelled.
- In the case that the contract has been initiated, the whole or part of the contract will be cancelled or terminated.
- The violator is prohibited from participating in any bids from six months to two years as of the date of debarment.
- The violator is ineligible for the exemption of bidding bonds in accordance with Article 37 of the Enforcement Decree of the 'Act on Contracts to which the State is a Party' regarding PPS bids for a two-year period after the debarment period has expired.

Integrity pledge for public procurement officials

Public procurement officials should pledge not to solicit grants or entertainment throughout the process of bidding, awards, contract establishment and implementation. A violation of integrity obligations will entail penalties, or joint responsibility in accordance with the relevant laws. The Standard Draft Integrity Pledge for Public Officials is contained in Annex 34.C.

Survey of Integrity Pact implementation status

Survey organisation

An external professional agency is in charge of surveys.

Survey method

Companies participating in bidding are randomly selected for the survey twice a year to determine the status of the implementation of the Integrity Pact, including any potential provision of grants or entertainment.

Survey results

Survey results are analysed to establish and implement improvement measures. These measures are established to prevent irregularities and to carry out intensive supervision of vulnerable divisions. The survey results are distributed to all divisions to raise awareness and for use as educational materials.

Effects of the Integrity Pact

The Integrity Pact has greatly raised awareness of the need for integrity among contracting companies and public procurement officials. It has reduced corruption in government procurement and encouraged better implementation of contracts.

Box 34.1. Number of integrity violations detected to date

2001	2 violations
2002	no violations
2003	1 violation
2004	no violations (as of October 2004)

Recommendations for introducing an integrity pact

Successful implementation requires strong will and continuous interest of the head of public procurement services to firmly establish an integrity pact. Measures to enhance transparency, including methods of disclosing information, would be helpful for the successful operation of the integrity pact. Continual education and awareness activities are also required for both contracting companies and public procurement officials.

Annex 34.A.

Special Bidding Instructions for the Integrity Pact

October 11, 2004

Article 1 (Objective)

These special bidding instructions for implementing the integrity pact aim to define special instructions other than general bidding instructions for prospective bidders on construction, goods and services through the PPS.

Article 2 (Submission of the Integrity Pledge for Contracting Companies)

a. All bidders are understood to have submitted the Integrity Pledge for Contracting Companies (Attachment 2), which stipulates that they will not commit any unfair acts, such as rigging the bid, throughout the process of bidding, awards, contract establishment, or its implementation. The Pledge is based on mutual trust between government officials and the bidder, and ensures that no illegal benefits such as grants or entertainment will be provided to relevant public procurement officials. Violators of the Pledge will be subject to penalties when participating in bidding or be forced to accept the cancellation of their contract. The representative of the company selected as the awardee shall sign and submit the Pledge after winning the bid. This contractor shall agree to accept the Integrity Pledge as part of the Specific Terms and Conditions of the Integrity Pact and duly comply with the conditions.

b. If the awardee refuses to reflect this Pledge in the specific terms and conditions of the integrity pact, and the contract is not established within a 10-day period following the notice of award, then the award will be cancelled.

Article 3 (Request for Integrity Pledge for Public Procurement Officials)

The head of the Public Procurement Service shall request public procurement officials, including the directors-general, directors, and officials of contract-related divisions to sign the Integrity Pledge (Annex 34.C.). All public procurement officials will then be required to abide by this Pledge, which specifies that they will not solicit nor receive grants or entertainment from bidders throughout the process of bidding, contract establishment and its implementation. The Pledge also stipulates that violators will accept any penalty deemed appropriate, including disciplinary measures according to the relevant laws.

Article 4 (Debarred Bidders' Limitations Regarding Participation in Bidding and Bidding Bond Payments)

a. If a bidder has committed any unfair acts such as fixing the bid prices or rigging the bid so that a certain bidder may win the bid, the company shall be subject to limitations when participating in bidding of the PPS or other end-user organizations according to the following provisions:

c) A bidder who has led others to rig a competitive bid so that a certain bidder may win the bid is prohibited from participating in bidding for a period of one to two years from the date of debarment.

d) In the event that a bidder was found to have had prior consultations with other bidders in a competitive bid to manipulate the bid price or rig the bid so that a certain bidder may become the awardee, this bidder is prohibited from participating in any PPS bids for a period of 6 months to one year from the date of debarment.

b. In the event that a bidder has committed unfair acts such as bid rigging, the bidder shall not raise any objections against the PPS for filing a complaint against his or her company with the Fair Trade Commission in accordance with the Monopoly Regulation and Fair Trade Act, and in addition to penalties outlined in Paragraph 1 of the current article.

c. Throughout the process of bidding, concluding and implementing a contract, a bidder shall not directly or indirectly provide any relevant public officials with illegal benefits including grants or entertainment. In the event that the bidder has violated these instructions, the bidder shall not participate in the bidding of the PPS or other end-user organizations for a period of between one to two years from the date of debarment. In addition, after the period of debarment expires, the bidder shall be required to pay for bidding bonds for a two-year period when participating in PPS bids according to Article 37 of the Enforcement Decree of the Act on Contracts to which the State is a Party.

d. Bidders who were debarred by the PPS according to Paragraphs 1 through 3 of the current article shall not file for any compensatory damage nor raise any civil or criminal objections against the PPS for being excluded from the bid.

Article 5 (Termination of the Contract)

a) With regards to bidding, awards, the establishment of the contract or its implementation, those who have provided grants or entertainment to relevant public officials shall be subject to the following penalties for the relevant contract according to each of the following provisions:

e) In the case where a contract has not yet been established, the violator will be excluded from the list of prospective awardees, or in the case where an awardee has already been determined, the decision shall be cancelled. However, if it is inevitable, for reasons related to an end-user organization's project, the PPS may decide not to do so.

f) In the case that a contract has been established but the construction has not begun, the contract shall be cancelled. However, if it is inevitable, for reasons related to an end-user organization's project, the PPS may decide not to do so.

g) In the case that the contract has been established and work has begun a part of or the whole of the contract shall be cancelled or terminated. However, if it is not possible to cancel or terminate the contract given the nature, progress, scope or implementation period stipulated in the contract, the PPS may decide not to do so.

h) A contractor shall not raise any civil or criminal objections against the PPS for imposing penalties according to Paragraphs 1 through 3 of the current article.

Article 6 (Others)

a. Employees and staff of a construction company, including a subcontractor and their proxies, shall make active efforts to establish a code of ethics designed to prohibit the provision of grants or entertainment to relevant public procurement officials and to prevent unfair acts such as bid rigging. They shall also make active efforts to establish corporate rules intended to remove or prevent any disadvantages for whistle blowers.

Addenda

Article 1. This rule shall take effect from the bid solicitation dated October 11, 2004.

Annex 34.B.

Integrity Pledge for Contracting Companies

Recognizing the real importance of a transparent, corruption-free business along with a fair governmental administration for social development and international competitiveness;

Aware of the OECD's Anti-Bribery Convention entering into effect internationally;

Actively responding to the spirit of the integrity pact in line with trends to strengthen sanctions against corrupt firms and/or countries;

The officers, and a proxy of our company, hereby make the following pledge when participating in Public Procurement Service (PPS) bids for construction work, goods and services.

a) We will not conduct any unfair acts which might hamper open competition. Such unfair acts include bid price fixing, bid rigging to ensure a certain bidder as an awardee, or prearrangement, determination, and agreement with other bidders.

   – In the event that our company was found to have led other bidders in rigging a competitive bid in order to ensure a certain bidder as the awardee, we will be forbidden from participating in Public Procurement Service bids for a period of one to two years from the date of debarment.

   – In the event that our company was found to have had prior consultations with other bidders in a competitive bid so as to manipulate the bid price or rig the bid to ensure a certain bidder as awardee, we will not participate in PPS bids for a period of 6 months to one year from the date of debarment.

   – In the event that our company was found to have committed any of the above-mentioned wrongdoings, we will not raise any objection to the PPS for filing a complaint against our company with the Fair Trade Commission, in accordance with the Monopoly Regulation and Fair Trade Act, which will impose penalties.

b) In the process of bidding, awards, and contract fulfilment, we will not directly or indirectly provide public procurement officials concerned with illegal benefits including grants and entertainment.

   – In the event that we have violated this pledge, and were found to have provided the said officials with grants or entertainment in relation to the bidding, awards, or establishment and implementation of the contract, we will be forbidden from participating in PPS bids or bids by relevant end-user organizations for a period of one to two years from the date of debarment. In addition, after the period of

debarment expires, we will be required to pay for bidding bonds for a two-year period when participating in PPS bids according to Article 37 of the Enforcement Decree of the Act on Contracts to which the State is a Party.

c) In the event that we were found to have provided relevant officials with grants or entertainment in relation to bidding, awards, establishment or implementation of a contract, we will accept the cancellation of the award before the establishment of the contract, cancellation of the contract before the implementation of the contract, or termination or cancellation of a part or whole of the contract after the implementation of the contract. We will not raise any civil or criminal objections related to these decisions.

d) We will endeavour to establish a code of ethics designed to prohibit our officers from providing grants or entertainment to relevant public procurement officials or from conducting unfair acts such as bid rigging. We will also establish corporate rules intended to prevent any disadvantages for whistle blowers.

As this integrity pledge is a commitment based on mutual trust, we will fully abide by this pledge under any circumstances. In the event that we are awarded a contract, we will accept this integrity pledge as part of the specific terms and conditions to the contract and implement them accordingly. We will not file a damage claim against the PPS when the PPS restricts our participation in any bids, or cancels a contract. We also pledge not to raise any civil or criminal objections against the PPS when the PPS excludes our company from bidding.

On this…day of…(date)

Pledged by:……..Representative of…..(Company)

To the PPS Administrator

Annex 34.C.

Standard Draft Integrity Pledge for Public Officials

Recognizing the importance of a corrupt-free administration for social development and national competitiveness, the PPS has put in place an integrity pact for all construction, goods and services of the PPS in order to maintain a corruption-free Procurement Service.

- In conducting procurement for all PPS construction, goods and services, as a member of…division at…bureau, as of…month…day,…year, I will conduct the work in a fair and transparent manner in accordance with relevant regulations, and will publicize my work in real time and actively co-operate with ombudsman activities so as to fulfil the integrity pact.
- I pledge that for whatever reason, I will not solicit nor receive illicit benefits such as grants or entertainment throughout the process of bidding, contract establishment and fulfillment, and that if I violate this pledge, I will shoulder the responsibility (joint responsibility) which will include disciplinary penalties according to the relevant laws. In addition, I will not take any action that may cause disadvantages for whistle blowers.

March, 2004

Official in charge of contract (Director-General)	Stamp
Director	Stamp
Junior Deputy Director or Senior Deputy Director	Stamp
Official concerned	Stamp

To the PPS Administrator

Annex 34.D.

Specific Terms and Conditions of the Integrity Pact

October 11, 2004

Article 1 (Objective)

The objective of the specific terms and conditions for the integrity pact are to establish special rules on integrity other than the general contract rules regarding the contracting of goods, services and construction between a PPS official in charge of contracts and a contractor.

Article 2 (Obligation to Comply with the Integrity Pact)

a) A bidder shall submit an integrity pledge for contracting companies in order to bid for goods, services or construction. In addition, a contractor or prospective contractor shall not provide illicit benefits such as grants or entertainment directly or indirectly to relevant officials for any reason, regarding the establishment or fulfilment of a contract.

Article 3 (Limitation of Debarred Bidders regarding Participation in Bidding and Payment of Bidding Bonds)

a) If a bidder has committed unfair acts such as fixing bid prices or rigging the bid in order to ensure that a certain bidder wins the bid, the company shall face limitations regarding participation in the bidding of the PPS or other end-user organizations according to each of the following provisions.

    e) If a bidder who has led others in rigging a competitive bid so as to ensure that a certain bidder wins the bid, will be prohibited from participating in bidding for a period of one to two years from the date of debarment.

    f) In the event that a bidder was found to have had prior consultations with other bidders in a competitive bid to manipulate the bidding price or rig the bid in order to ensure a certain bidder as the awardee, the bidder is prohibited from participating in any PPS bids for a period of 6 months to one year from the date of debarment.

b) In the event that a bidder was found to have committed unfair acts such as rigging the bid, the bidder shall not raise any objections to the PPS for filing a complaint against his or her company with the Fair Trade Commission in accordance with the Monopoly Regulation and Fair Trade Act, and in addition to penalties outlined in Paragraph 1 of the current article.

c) In the process of bidding, concluding and implementing a contract, a bidder shall not directly or indirectly provide relevant public procurement officials with any illegal benefits including grants or entertainment. In the event that the bidder has violated this provision, the bidder shall not participate in the bidding of the PPS or other end-user organizations for a period of one to two years from the date of debarment. In addition, after the period of debarment expires, the bidder shall be required to pay for bidding bonds for a period of two years when participating in PPS bids according to Article 37 of the Enforcement Decree of the Act on Contracts to which the State is A Party.

d) The company which has been debarred by the PPS according to Paragraph 1 or 3 shall not request any compensatory damage nor raise any civil or criminal objections against the PPS for being excluded from the bid.

Article 4 (Termination of the Contract)

a. With regards to bidding, awards, negotiations, the establishment or fulfilment of a contract, those who have provided grants or entertainment to relevant public procurement officials shall be subject to the following penalties according to each of the following provisions.

g) In the case that a contract has been established but the construction has not begun, the contract shall be cancelled. However, if it is inevitable, for reasons related to an end-user organization's project, the PPS may decide not to do so.

h) In the case that the contract has been established and work has begun, a part of or the whole of the contract shall be cancelled or terminated. However, if it is not possible to cancel or terminate the contract given the nature, progress, scope or implementation period stipulated in the contract, the PPS may decide not to do so.

i) A prospective contractor shall not raise any civil or criminal objections against the PPS for imposing penalties according to Paragraphs 1 through 2 of the current article.

Article 5 (Others)

a. Employees and staff of a construction company, including a subcontractor and their proxies, shall make active efforts to establish a code of ethics designed to prohibit the provision of bribery to relevant public procurement officials and to prevent unfair acts such as bid rigging. They shall also make active efforts to establish corporate rules intended to prevent any disadvantages for whistle blowers.

Addenda

Article 1. This rule shall take effect from the bid solicitation dated October 11, 2004.

Annex I

Agenda of the OECD Global Forum on Governance: Fighting Corruption and Promoting Integrity in Public Procurement

29 November 2004	
	Opening of the Global Forum ***Mr. François Loos***, Minister for Foreign Trade, France ***Mr. Richard Hecklinger***, OECD Deputy Secretary-General
Plenary I	**Fighting corruption and improving transparency in public procurement** ***Chair: Mr. Richard Hecklinger***, OECD Deputy Secretary-General
	Keynote speeches ***Professor Mark Pieth***, Chair, OECD Working Group on Bribery in International Business Transactions, University of Basel, Switzerland ***Mr. Kyung-soo Choi***, Head of Public Procurement Service, Republic of Korea
	Panel discussion on fighting corruption and improving transparency in public procurement ***Moderator: Mr. Pierre-Christian Soccoja,*** Service central de prévention de la corruption, France ***Panellists:*** ***Mr. Roberto Anaya,*** Undersecretary, Ministry of Public Administration, Mexico ***Professor Frédéric Jenny***, Chair, OECD Competition Committee, France ***Mr. Richard A. Kell***, President, International Federation of Consulting Engineers, FIDIC ***Ms. Elena Panfilova***, Executive Director, Transparency International, Russia
	General discussion
Parallel Break-out Sessions: Workshops 1 and 2	
Workshop 1	**Identifying risks in the bidding process to prevent corruption** ***Chair: Professor Giorgio Sacerdoti,*** Bocconi University, Italy and Member of the WTO Appellate Body

	Discussants: ***Mr. Jean-Pierre Bueb,*** Service central de prévention de la corruption, France ***Ms. Diana Kurpniece***, Head of Public Relations and International Co-operation Division Corruption Prevention and Combating Bureau, Latvia ***Mr. Guillermo Haro***, Head of Procurement Standards, Mexico ***Mr. Brig Nasir Mahmood*****,** Head of Department, National Anti-Corruption Strategy, National Accountability Bureau, Pakistan ***Mr. Nicolás Raigorodsky***, Undersecretary and Director of Policies of Transparency at the Anticorruption Office, Argentina ***Mr. Paul Lachal Roberts,*** Adviser, Multi-Agency Investigations, OLAF (European Anti-Fraud Office), European Commission ***Mr. A. Michael Stevens***, Principal Audit Specialist (Financial Investigator), Anticorruption Unit, Office of the Auditor General, Asian Development Bank
Workshop 2	**Improving transparency in public procurement** ***Chair: Mr. Jacques Bayle***, Inspecteur Général des Finances, France ***Discussants***: ***Mr. Rob Burton,*** Acting Administrator, Executive Office of the President, Office of Federal Procurement Policy, United States ***Mr. Peter Trepte,*** Barrister, Littleton Chambers, London ***Mr. Claudio Weber Abramo***, Executive Director, Transparência Brasil ***Mr. Ditmar Waterman***, Public Procurement Policy, European Commission ***Ms. Åse Grødeland***, Norwegian Institute of Urban and Regional Research ***Mr. Chun-Soo Hong,*** Director, Department of Planning and Budget, Public Procurement Service, Republic of Korea ***Ms. Carmel Madden,*** Information Society Policy Unit, Department of the Taoiseach, Ireland
Plenary II	**Reporting back from Workshops 1 and 2 (Workshop Chairs and Rapporteurs)** ***Chair: Ms. Birgitta Nygren,*** Ambassador, Ministry of Foreign Affairs, Sweden.
	The workshop Chairs and Rapporteurs will report on the main issues discussed in the workshops. They will summarise the key issues and viewpoints raised in the discussions and expose the ensuing conclusions reached in the workshops. Participants will be invited to comment on the main findings and possibly make suggestions regarding the follow-up.

30 November 2004	
Parallel Break-out Sessions: Workshops 3, 4 and 5	
Workshop 3	**Ensuring accountability: Designing and controlling sound procurement procedures** ***Chair: Mr. Jonathan Denison Cross,*** Procurement Policy Unit, International Office of Government Commerce, United Kingdom ***Discussants:*** ***Mr. Wayne Wittig,*** International Procurement Adviser, Jefferson Consulting, United States ***Professor Yu An***, Tsinghua University, China ***Mr. Eric Sitbon***, Administrator, European Commission, DG Internal Market, Public Procurement Policy Directorate ***Ms. Tina Soreide,*** Chr. Michelsen Institute, Norway ***Mr. András Nagy***, Legal Advisor, Public Procurement Council, Hungary ***Ms. Alina Hussein***, Adviser to the SCC President, Supreme Chamber of Control, Poland
Workshop 4	**Compliance with anti-corruption laws through access to public procurement: sanctioning or voluntary self regulation?** ***Chair: Ms. Valérie Dervieux*** , Magistrate, France ***Discussants:*** ***Ms. Françoise Bentchikou***, Chief Counsel, Procurement and Consultant Services, The World Bank ***Ms. Kirstine Drew***, UNICORN: Global Trade Unions Anti-corruption Project, University of Greenwich, United Kingdom ***Mr. Jean-Pierre Méan***, General Counsel and Chief Compliance Officer, Société Générale de Surveillance, Switzerland ***Mr. Michael Wiehen***, Transparency International, Germany ***Ms. Simone White***, Principal Administrator, OLAF (European Anti-Fraud Office), European Commission
Workshop 5	**Development assistance co-operation: How building procurement capacities can help improve integrity** ***Chair: Mr. Richard Manning***, Chair, OECD Development Assistance Committee ***Discussants:*** ***Mr. Phil Mason,*** Anti-Corruption Team Leader, Governance Department, Department for International Development (DFID), United Kingdom ***Mr. George Carner***, Representative of the United States to the OECD Development Assistance Committee, Permanent Delegation of the United States to the OECD
Plenary III	**Reporting back from workshops (Workshop Chairs and Rapporteurs)** ***Chair: Ms. Birgitta Nygren,*** Ambassador, Ministry of Foreign Affairs, Sweden
	The workshop chairs and rapporteurs will report on the main issues discussed in the workshops. They will summarise the key issues and viewpoints

	raised in the discussions and expose the ensuing conclusions reached in the workshops. Participants will be invited to comment on the main findings and possibly make suggestions regarding the follow-up.
Plenary IV	**Future direction to fight corruption and promote integrity in public procurement** ***Moderator:*** ***Professor Mark Pieth***, Chair, OECD Working Group on Bribery in International Business Transactions, University of Basel, Switzerland
	Panel discussion on future direction to fight corruption and promote integrity in public procurement ***Discussants:*** ***Mr. Rob Burton,*** Acting Administrator, Executive Office of the President, Office of Federal Procurement Policy, United States ***Ms. Eva Joly,*** Special Adviser to the Government, Ministry of Justice and Police, Norway ***Mr. Claudio Weber Abramo***, Executive Director, Transparência Brasil
	General discussion
	Conclusions of the Global Forum ***Ms. Odile Sallard***, Director, OECD Public Governance and Territorial Development Directorate ***Mr. Rainer Geiger***, Deputy Director, OECD Directorate for Financial and Enterprise Affairs

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Fighting Corruption and Promoting Integrity in Public Procurement

Much is at stake in the global effort to tackle corruption in public procurement. Corruption diverts public funds from worthwhile development projects, holds back economic growth and undermines public trust in government.

Public procurement – the purchase of goods and services by governments and state-owned enterprises – accounts for about 15 per cent of GDP in OECD countries and is highly exposed to corruption. Both public and private actors in the procurement process may be tempted to divert goods and services or public funds for their personal use.

To identify "weak links" in the public procurement process where the risk of corruption is high, to explore the best ways of improving transparency and accountability and to identify effective actions to prevent, detect and sanction corruption in this field, the OECD organised a Global Forum on Governance event on "*Fighting Corruption and Promoting Integrity in Public Procurement*", hosted by the French Ministry of Economy, Finance and Industry in Paris in November 2004.

This publication captures the main points of the Global Forum discussions and presents expert analysis of the main issues and case studies from the varied experiences of countries and specialised bodies, mainly in Europe, Asia and Latin America, that contributed to the event.

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