

# Public Procurement: Where the Public and Private Sectors Do Business

*Residents of Nairobi are facing severe water rationing on top of 12-hour electricity blackouts on six days of the week because of drought. Small businesses cannot function. Residents even find they cannot pay their electricity bills because most post offices have no power. "Islands of power" continue, so that the President's residence is unaffected, and when the President spoke on television electricity was supplied for the duration of his speech, but when he sat down it was turned off again. Officials blamed the drought, but many Kenyans believe that corruption lies at the root of the crisis. Diplomatic observers query why it is that Kenya should rely on hydro-electric power when it has always been susceptible to drought. "The answer lies in the lucrative business contracts for government officials generated by such large projects," they say.*

*"Nairobi's water is rationed in drought", Daily Telegraph, 13 July 2000.*

Mention the subject of corruption in government and most people will immediately think of bribes paid or received for the award of contracts for goods or services, or - to use the technical term - procurement.<sup>1</sup>

Few activities create greater temptations or offer more opportunities for corruption than public sector procurement. Every level of government and every kind of government organisation purchases goods and services, often in quantities and monetary amounts that defy comprehension. Whether this is really the most common form of public corruption may be questionable but without doubt it is alarmingly widespread and almost certainly the most publicised. Hardly a day goes by without the revelation of another major scandal in public procurement somewhere in the world.

It has been the cause of countless dismissals of senior officials, and even the collapse of entire governments. It is the source of astronomical waste in public expenditure, estimated in some cases to run as high as 30 percent or more of total procurement costs. Regrettably, however, it is more talked about than acted upon.

To the non-specialist, the procurement procedures appear complicated, even mystifying. They are often manipulated in a variety of ways, and without great risk of detection. Some would-be corrupters, on either side of transac-

### Public procurement - Private profit

The Hungarian government has issued a decree listing the companies from which institutions must make official purchases.... "It's tying our hands and telling us what to do," remarked bitterly a project co-ordinator for a post-secondary academic institution on condition of anonymity. "We have no control over how money comes in and to whom it goes. We already have enough to do as it is in order to secure funding without being told where to spend our money."

...What has upset many project co-ordinators and those in charge of procurement for their institutions is that no details were made public of how this list had been compiled. What is more, many of the companies listed are not regarded highly. They are seen by many as offering equipment that is overpriced and of poor quality.

Public procurement doesn't have a good track record in Hungary. Computers and other equipment were usually purchased from a certain place not after a careful and comparative consideration of product, price, and service, but from where a spouse, family member, or relation of a colleague or friend happen to work....

One of the main reasons for this is because public procurement is traditionally seen by administrators as a shopping spree, with much of this equipment winding up in private hands...

*John Horvath, Telepolis magazin  
der netzkultur, 22 May 1998*

<sup>1</sup> For details, see General Agreement on Tariffs and Trade (GATT). *Agreement on Government Procurement*, 1988; United Nations Commission on International Trade Law (UNCITRAL); *Model Law on Procurement of Goods, Construction and Services*, 1994;

World Bank *Guidelines for Procurement Under IBRD Loans and IDA Credits*, 1995; Official Journal of the European Communities, Procurement Directives; and International Trade Centre UNCTAD/GATT, *Improving Public Procurement Systems*, 1993.

tions, often find ready and willing collaborators. Special care is needed, as the people doing the buying (either those carrying out the procurement process or those approving the decisions) are not concerned about protecting their own money, but are spending “government” money.

Such is the importance of public procurement that South Africa accorded it special attention in its 1994 Constitution. Section 187 provides that:

(1) The procurement of goods and services for any level of government shall be regulated by an Act of Parliament and provincial laws, which shall make provision for the appointment of independent and impartial tender boards to deal with such procurements.

(2) The tendering system referred to in subsection (1) shall be fair, public and competitive, and tender boards shall on request give reasons for their decisions to interested parties.

(3) No organ of state and no member of any organ of state or any other person shall improperly interfere with the decisions and operations of the tender boards.

(4) All decisions of any tender board shall be recorded.

Corruption in procurement is sometimes thought to be a phenomenon found only in developing countries with weak governments and poorly paid staffs. The “most developed” countries have amply demonstrated in recent years that corrupt procurement practices can become an integral part of their doing business. Nor is procurement corruption the exclusive domain of the buyer who controls the purse strings: it can just as easily be initiated by the supplier or contractor who makes an unsolicited offer. The real issue, of course, is what can be done about it?

### Principles of fair and efficient procurement

*Procurement should be economical.* It should result in the best quality of goods and services for the price paid, or the lowest price for the acceptable quality of goods and services; not necessarily the lowest priced goods available; and, not necessarily the absolutely best quality available, but the best combination to meet the particular needs.

“Price” is usually “evaluated price” – meaning that additional factors such as operating costs, availability of spares, servicing facilities are taken into account.

*Contract award decisions should be fair and impartial.* Public funds should not be used to provide favours; standards and specifications must be non-discriminatory; suppliers and contractors should be selected on the basis of their qualifications and the merit of their offers; there should be equal treatment of all in terms of deadlines, confidentiality, and so on.

*The process should be transparent.* Procurement requirements, rules and decision-making criteria should be readily accessible to all potential suppliers and contractors, and preferably announced as part of the invitation to bid. The opening of bids should be public, and all decisions should be fully recorded in writing.

*The procurement process should be efficient.* The procurement rules should reflect the value and complexity of the items to be procured. Procedures for small value purchases should be simple and fast, but as purchase values and complexity increase, more time and more com-

plex rules will be required to ensure that principles are observed. “Decision making” for larger contracts may require committee and review processes, however bureaucratic interventions should be kept to a minimum.

*Accountability is essential.* Procedures should be systematic and dependable, and records explaining and justifying all decisions and actions, should be kept and maintained.

Competence and integrity in procurement encourages suppliers and contractors to make their best offers and this in turn leads to even better procurement performance. Purchasers who fail to meet high standards of accountability and fairness are quickly identified as poor partners with which to do business.

When a project is funded by an International Financial Institution (IFI), additional requirements usually apply:

- A fair chance must be given for all suppliers/contractors/consultants from all or some other countries, especially for suppliers and contractors: usually donor member countries;
- Suppliers/bidders or contractors from the host country may sometimes be entitled to a preference expressed as a percentage of the contract value (World Bank: 15% for goods contracts, 7.5% for works contract); this is usually announced in the bid invitation;
- For contractors, there is often a requirement of pre-qualification (explained further below);
- For consultants, there is usually a “short list” of those invited to bid (the list to be prepared by the purchaser, not the funding institution). This avoids expensive preparatory efforts by too many consultants when only one can get the contract. The “short list” must have geographic variety (usually no more than two from one country); there may be encouragement for foreign consultants to include consultants from the host country for at least part of the job; and there may also be encouragement for joint ventures involving foreign and local consultancy firms.

When a project is funded by the UN, the “purchaser” is, in most cases, the UN organisation itself. Although the UN basically applies similar procurement standards as those described above, it makes special efforts to procure from countries which are donor countries, but which in the past have received a disproportionately small share of UN procurement, or from countries in which the UN is holding large sums of non-convertible funds.

On the one hand there are principles that it make sense for every purchaser to apply; and on the other hand there are the specific requirements of financial institutions (especially the multilateral development banks) for procurement financed out of their loans and credits.

Clearly, bribery and corruption need not be a necessary part of doing business. Experience shows that much can be done to curb corrupt procurement practices if there is a desire and a will to do so. In order to understand how best to deal with corruption in procurement, it helps to know first how it is practised.<sup>2</sup>

## How corruption poisons procurement

Contracts involve a purchaser and a seller. Each has many ways of corrupting the procurement process, and at any stage.

<sup>2</sup> A checklist prepared by the (Hong Kong) Independent Commission Against Corruption appears in the Best Practice compila-

tion on the Internet version of this Source Book: [www.transparency.org](http://www.transparency.org).

Before contracts are awarded, the purchaser can:

- tailor specifications to favour particular suppliers;
- restrict information about contracting opportunities;
- claim urgency as an excuse to award to a single contractor without competition;
- breach the confidentiality of suppliers' offers;
- disqualify potential suppliers through improper prequalification; and
- take bribes.

At the same time, suppliers can:

- collude to fix bid prices;
- promote discriminatory technical standards;
- interfere improperly in the work of evaluators; and
- offer bribes.

The most direct approach is to contrive to have the contract awarded to the desired party through direct negotiations without any competition. Even in procurement systems which are based on competitive procedures, there are usually exceptions where direct negotiations are permitted - for example:

- (a) in cases of extreme urgency because of disasters,
- (b) in cases where national security is at risk,
- (c) where additional needs arise and there is already an existing contract, or
- (d) where there is only a single supplier in a position to meet a particular need<sup>3</sup>.

Of course, not all single-sourced contracts are corrupt. In some instances, direct contract negotiations may well be the most appropriate course of action. However, if justifying circumstances are claimed that do not really exist, the reason is often to cover up and permit corruption.

Even if there is competition, it is still possible to tilt the outcome in the direction of a favoured supplier. If only a few know of the bidding opportunity, competition is reduced and the odds improve for the favoured party to win. One ploy is to publish the notification of bidding opportunities in the smallest, most obscure circulation source that satisfies the advertising requirements and hope that no one sees it. Cooperative bidders, of course, get firsthand information.

Bidder competition can be further restricted by establishing improper or unnecessary prequalification requirements - and then allowing only selected firms to bid. Again, prequalification, if carried out correctly, is a perfectly appropriate procedure for ensuring that bidders have the right experience and capabilities to carry out a contract's requirements. However, if the standards and criteria for qualification are arbitrary or incorrect, they can become a mechanism for excluding competent but unwanted bidders.

Persistent but unwanted parties who manage to get past these hurdles can still be effectively eliminated by tailoring specifications to fit a particular supplier. Using the brand name and model number of the equipment from the preferred supplier is a bit too obvious, but the same results can be achieved by including specific dimensions, capacities and trivial design features that only the favoured supplier can meet. The inability and failure of competitors to be able to meet these features, which usually have no bearing on critical performance needs, are used as a ploy to reject their bids as being "non-responsive."

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<sup>3</sup> E.g. The only manufacturer of a unique piece of equipment; the only supplier with current stocks large enough to meet an urgent order, etc.

Competitive bidding for contracts can only work if the bids are kept confidential up until the prescribed time for determining the results. A simple way to predetermine the outcome is for the purchaser to breach the confidentiality of the bids, and give the prices to the preferred supplier to submit a lower figure. The mechanics are not difficult, especially if the bidders are not permitted to be present when the bids are opened.

The final opportunity to distort the outcome of competitive bidding is at the bid evaluation and comparison stage. Performed responsibly, this is an objective analysis of how each bid responds to the requirements of the bidding documents and a determination of which one is the best offer. If the intention is to steer the award to a favoured bidder, the evaluation process offers almost unlimited opportunities: if necessary, and unless prevented from doing so, evaluators can invent entirely new criteria for deciding what is “best”, and then apply them subjectively to get the “right” results. They are often aided in this process by issuing bidding documents that are deliberately vague and obscure about what requirements must be met and how selection decisions will be made.

These techniques are only a brief outline of some of the ways in which a purchaser is able to corrupt the procurement process.

It would be a mistake to think that the buyers are always the guilty parties: just as often, they are the ones being corrupted by the sellers, although perhaps without undue resistance.

Through bribes and other incentives, sellers can encourage buyers to take any of the actions described above. In addition, they may collude with other suppliers to decide which party will win a contract and then fix their prices accordingly – “bid rigging” – with an agreed payoff for the losers. This may be done without any knowledge of the buyer, and, if done cleverly, may never raise suspicions unless it occurs repeatedly. Even then, it may be hard to prove, let alone to punish.

Nor does the story end with the award of the contract, even though that is the stage most think of when corruption in procurement is discussed. Indeed, the most serious and costly forms of corruption may take place after the contract has been awarded, during the performance phase. It is then that the purchaser of the goods or services may:

- fail to enforce quality standards, quantities or other performance standards of the contract;
- divert delivered goods for resale or for private use; and
- demand other private benefits (trips, school tuition fees for children, gifts).

For his part, the unscrupulous contractor or supplier may:

- falsify qualities or standards certificates;
- over or under-invoice;
- pay bribes to contract supervisors.

If the sellers have paid bribes or have offered unrealistically low bid prices in order to win the contract, their opportunities to recover these costs arise during contract performance. Once again, the initiative may come from either side but, in order for it to succeed, corruption requires either active cooperation and complicity or negligence in the performance of duties by the other party.

Unscrupulous suppliers may substitute lower quality products than were originally required or offered in their bid. They may falsify the quantities of goods or services delivered when they

submit claims for payment, and pay more bribes to contract supervisors to induce them to overlook discrepancies. In addition to accepting bribes and failing to enforce quality and performance standards, buyers may divert delivered goods and services for their private use or for resale.<sup>4</sup>

### Acceptance of gifts

Bribes can take the form of “gifts” and “gifts” can take many forms - a lunch, a ticket to a sports event, a Rolex watch, shares in a company, a holiday abroad, the school fees for a child. Some are acceptable; others are not.<sup>5</sup>

Throughout the developed world, the concept of the “hospitality tent” at major sporting functions has become big business. In the tents, more often than not, purchasing officers from the private and public sectors enjoy hospitality they cannot reciprocate, yet it is offered because it seems to make commercial sense to the hosts as a way of keeping on good terms with existing customers as well as to attract new business. Is this corrupt?

The answers can vary. Evaluations of such practices may turn on whether or not supervisors are in a position to monitor the consequences of their purchasing officers’ behaviour. Also relevant is whether a particular purchasing officer disqualifies him or herself in future situations where the firm in question is involved. Likewise, it will matter whether all the companies, likely to get the business, are acting in similar ways, so that no “obligation” to prefer one bidder over another is created. Furthermore, levels of hospitality which are expected and usual, and do not give rise to a sense of obligation, can vary considerably from one society to another.<sup>6</sup>

What is clearly unacceptable is where hospitality given is grossly excessive, such as all-expenses-paid holidays for a purchasing officer and spouse.<sup>7</sup> Less obviously unacceptable are such things as lunches or festive presents; though even here, the acceptance of seemingly trivial gifts and hospitality can, over time, lead to situations where an official has unwittingly become ensnared by the giver.

The dividing line usually rests at the point where the gift places the recipient under some obligation to the gift-giver. This point will differ from one society to another, but it is usually defined in terms of cash (or hospitality) which must be reported as being in excess of a given figure. Attempts to make distinctions between “private” hospitality and “hospitality in a public capacity” generally give rise to controversy, and so are best avoided.<sup>8</sup>

### Employment after holding public office

A crucial area of corruption - and one of growing concern - is the practice of corporations offering post-official employment to public servants with whom they have had official dealings.<sup>9</sup>

Clearly, regulations governing the post public sector employment of officials are important. It

4 For a description of collusion and kickbacks occurring in spite of international competitive bidding procedures being used, see Robert Klitgaard, *Controlling Corruption* (University of California Press, 1988), p.136 ff.

5 A group of property developers in Britain was asked in confidence how they identified particular planning officials who would be prepared to take bribes. The answer was revealing. “We ask them out to lunch. If they are so stupid as to accept an offer of hospitality from a property developer, they will also be good for a bribe”, was the reply.

6 It is open for consideration whether traditional exchanges of

gifts can or cannot be made.

7 Such holidays were provided, for example, in the early 1990s to purchasing staff at Britain’s Ministry of Defence. Large sums were spent on staff receiving holidays they could otherwise have only dreamed of.

8 Sample rules on gifts appear in the Best Practice compilation on the Internet version of this Source Book: [www.transparency.org](http://www.transparency.org).

9 The question of post public sector employment is also discussed under the chapter on Conflict of Interests.

is neither practical nor sensible to insist that former public officials not engage in commercial activity after leaving office. However, whole networks of corruption can be constructed by outside suppliers, not only through cash bribes and expensive overseas holidays, but also through the promise to officials of lucrative employment when they retire.

It is tempting for a public official, blessed with rich work experience but a less than satisfactory pension, to accept employment with former suppliers. Often, there will be nothing wrong with such an arrangement. Indeed, it may be a constructive and useful way to ensure that valuable experience is not altogether lost to the community.

But it is susceptible to abuse. For example, an official who leaves the public service may take with him detailed knowledge of the government's impending contract bargaining strategy and the confidential discussions that may have been held with competitors of the official's new, post-retirement employer. In such an instance, neither the public interest nor the private sector is well served.

The promise of post-retirement employment can be used, too, by unscrupulous businesses as a "sweetener" to gain contracts and is one that will not show in any monitoring of assets or income. Although it is neither fair nor desirable to place an absolute ban on re-employment past retirement, some kinds of employment after leaving office are clearly contrary to the public interest.<sup>10</sup> For example, a minister or highly-placed official may leave government service while negotiations for a large public works project are pending. Obviously it would be improper for such a person to immediately take up employment with one of the companies tendering or actively negotiating with the government.

### **What can be done to combat corruption in procurement?**

The most powerful tool is public exposure. The media can play a critical role in creating public awareness of the problem and generating support for corrective actions. If the public is provided with the unpleasant and illegal details of corruption - who was involved, how much was paid, how much it cost them - and if it continues to hear about more and more cases, it is hard to imagine that the people will not come to demand reform.

Government officials around the world are discovering that taxpayers still think of public funds as their money and do not like to see it wasted. The public, of course, is particularly unhappy when it sees its money going into the pockets of others as a reward for corrupt practices. Once support is developed for the reform of procurement practices, the problem can be attacked from all sides. Usually the starting point will be the strengthening of the legal framework, beginning with an anti-corruption law that has real authority and effective sanctions.

One of the greatest anomalies in anti-corruption laws regarding public procurement is that most countries clearly prohibit bribery at home, but many are silent when their exporters are bribing abroad, or even reward it through tax write-offs.

At best, this is justified by a misguided notion of what is necessary for successful international business; at worst, it reflects a cynical and paternalistic view of what is good for others. Of all the major powers, only the United States has had a Foreign Corrupt Practices Act - since 1977 - that specifically makes it a crime under its domestic laws to bribe foreign officials to gain or

<sup>10</sup> See the rules relating to conflict of interest and post-public sector employment in force in e.g. Canada in the Best Practice

compilation on the Internet version of this Source Book: [www.transparency.org](http://www.transparency.org).

maintain business, even when these events take place abroad. The OECD Convention, directed at outlawing international business corruption involving public officials, in essence aims to internationalise the US approach.<sup>11</sup>

The next legal requirement is a sound and consistent framework establishing the basic principles and practices to be observed in public procurement.

This can take many forms, but there is increasing awareness of the advantages of having a unified Procurement Code, setting out clearly the basic principles, and supplementing this with more detailed rules and regulations within the implementing agencies. A number of countries are consolidating existing laws, which have often developed haphazardly over many years, into such a code.<sup>12</sup>

In recent years, some of the largest multilateral development agencies have given support to the development of national procurement codes in the countries to which they are lending, and have fostered organisations to implement them. For years, each of these lending institutions has had its own procurement guidelines, which borrowers are required to follow when awarding contracts financed from their loans. These guidelines have, in fact, had a significant role in shaping what are now widely accepted as standards of good international procurement practice.

Unfortunately, the rules applied by the multilateral development agencies do not directly impact on corruption in procurement for projects financed through other sources. However, more recently, the development banks have recognised that it is in their member countries' best interests to have national policies and procedures which apply these standards to other forms of procurement. Support from the banks includes both financial and technical assistance to countries that are willing to undertake procurement reforms, and associated institutional development.

### Transparency procedures

Beyond the legal framework, the next defence against corruption is a set of open, transparent procedures and practices for conducting the procurement process itself. No one has yet found a better answer than supplier or contractor selection procedures based on real competition.

The complexity or simplicity of the procedures will depend on the value and nature of the goods or services being procured, but the elements are similar for all cases:

- describe clearly and fairly what is to be purchased;
- publicise the opportunity to make offers to supply;
- establish fair criteria for selection decision-making;
- receive offers (bids) from responsible suppliers;
- compare them and determine which is best, according to the predetermined rules for selection; and,
- award the contract to the selected bidder without requiring price reductions or other changes to the winning offer.

For small contracts, suppliers can be selected with very simple procedures that follow these principles. However, major contracts should be awarded following a formal competitive bidding process involving carefully prepared specifications, instructions to bidders and proposed

11 The US Foreign Corrupt Practices Act is discussed in *Should Foreign Bribery be a Crime?* by Fritz Heimann on the Transparency International web site: [www.transparency.org](http://www.transparency.org).

12 Several models are available as a starting point: those devel-

oped by the GATT/World Trade Organization, the United Nations Committee on International Trade Law (UNCITRAL), and the European Union. There are also various national codes.

contracting conditions, all incorporated in the sets of bidding documents that are usually sold to interested parties.

Such documents may take months to prepare, and many more months may be needed for suppliers to prepare their bids and for the purchaser to evaluate them and choose the winner. These steps commonly take six months or more from start to finish. Procurement planning must be sure to take these time requirements into account, and start early enough to ensure that the goods and services will be ready when needed. Any pressures for “emergency” decisions should be avoided.

## Opening of bids

One key to transparency and fairness is for the purchaser to open the bids at a designated time and place in the presence of all bidders or their representatives who wish to attend. A practice of public bid openings, where everyone hears who has submitted bids and what their prices are, reduces the risk that confidential bids will be leaked to others, overlooked, changed or manipulated.

Some authorities resist this form of public bid opening, arguing that the same results can be achieved by having bids opened by an official committee of the purchaser without bidders being present. Clearly this does not have the same advantages of perceived openness and fairness, especially since it is widely believed, and it is often the case, that a purchaser is a participant in corrupt practices.

## Bid evaluation

Bid evaluation is one of the most difficult steps in the procurement process to carry out correctly and fairly. At the same time it is one of the easiest steps to manipulate if someone wants to tilt an award in the direction of a favoured supplier.

Evaluators can reject unwanted bids for trivial procedural matters - an erasure, failure to initial a page - or for deviations from specifications that they decide are significant. After bids are examined, if no one prevents them, evaluators may discover entirely new considerations that should be taken into account in choosing the winner. Or the bid evaluation criteria may be so subjective and so lacking in objective qualitative measures that the evaluators' scoring can produce any result they wish.

All of this argues for requiring bid evaluation criteria to be spelled out clearly in bid documents and for an impartial review authority to check the reasonableness of the evaluators' actions. The former allows bidders to raise objections in advance if they consider that the criteria are not appropriate, and the latter provides additional assurance that an evaluation has been conducted properly.

## Delegations of authority

The principle of independent checks and audits is widely accepted as a way in which to detect and correct errors or deliberate manipulation, and it has an important place in public procurement. Unfortunately, it has also been used by some to create more opportunities for corruption. In particular, the delegation of authority for contract approvals is an area that warrants some discussion.

### On-Line procurement advances

A few countries have moved unilaterally to enhance access to procurement information. Mexico, Korea and Chile have put substantial amounts of public procurement information on-line. Mexico's CompraNet publishes procurement opportunities, bid documents, relevant laws and procedures, and results of the tenders online. Mexico expects to implement completely electronic procurement shortly. The government says it has had over 2 million “hits” to date and that CompraNet's greater transparency and lowered cost have met with positive reviews. Chile has designed a similar information system with legislative approval of on-line tendering pending.

The procurement systems can be found at:  
[www.compranet.gob.mx](http://www.compranet.gob.mx) and  
[www.compraschile.cl](http://www.compraschile.cl).

*TI-USA newsletter, January 2000*

At face value, the rationale for delegation is convincing: low-level authorities can make decisions about very small purchases, but higher levels should review and approve these decisions for larger contracts. The larger the contract value, the higher should be the approving authority. A desk purchase can be approved by the purchasing agent; a computer must be approved by a director; a road must be approved by a Minister; and a dam may need to be approved by the President.

In some countries and organisations, this system works without any problems. In others, where contract awards are the main path to riches, it means a graduated payoff can be required at each step of the way: the higher the path leads, the larger the percentages demanded. Coincidentally, it also means that the larger the contract, the longer the delays in reaching any decision. All this points to a further essential element for reducing corruption: a well-trained, competent and honest body of civil servants to carry out procurement.

Establishing such a group requires a long-term effort, one that is never completely done. It requires regular training and re-training programmes; security in the knowledge that one's job will not be lost if the winning contractor is not the one favoured by the Minister; and at least a level of pay that does not make it tempting to accept bribes to meet the bare necessities of a family. If a competent procurement cadre is developed, and there are a number of places where this has been achieved, the chain of approving authorities, with its accompanying delays, and other hazards can be reduced to a minimum.

### Independent checks and audits

None of this is to suggest that all independent checks and audits should be eliminated; they have an important role. However, there are some countries where so many review and approval stages have been built into the process that the system is virtually paralysed. In some, it is impossible to award a major contract in less than two years from the time the bids are received.

### Additional reforms

The list of actions suggested here is lengthy, but looks at the subject broadly, rather than examining such technical details as the standardisation of bidding documents and the establishment of simplified purchasing procedures for special kinds of procurement.

Public information programmes about procurement must address all parties - the officials who have responsibilities for procurement, the suppliers and contractors who are interested in competing for contracts, and the public at large. The messages should be:

- that the particular jurisdiction, whether a nation or one of its organisations, possesses clearly stated rules of good procurement practice which it intends to enforce rigorously;
- that violators of the rules will be prosecuted under the law;
- that officials who indulge in corrupt practices will be dismissed; and
- that bidders who break the rules will be fined, possibly jailed, and excluded from consideration for any future contracts, by being "blacklisted".<sup>13</sup>

13 Public authorities within the EU are provided with power to exclude contractors who have engaged in "unprofessional" conduct or criminal offences, from bidding for their business. They are empowered to exclude a company which has been convicted of an offence concerning its professional conduct in a judgment which has the force of *res judicata* (a legal determination); or which has been guilty of grave professional misconduct proven by any means which the contracting authorities can justify. (Article 29 of the Directive on Public Service Contracts, EC 92/50). Although this power has existed for some

years, public authorities have seemed unwilling to exercise it. In 1993 three firms named in court as having paid £1.5 million in bribes to a Ministry of Defence official in the United Kingdom were still on that government's list of approved tenderers two years later. (*Times*, 20 November 1995). Given such tacit acceptance of such conduct, a bribe becomes a risk-free investment from which a bidder can only win. A more aggressive approach has been adopted by the World Bank in recent times, with "blacklisted" firms being posted on its web site.

Whatever statements are made must then be backed up by appropriate actions.

It should be clear that none of the actions suggested here is sufficient by itself to curb corruption in procurement; however, a co-ordinated effort on all fronts will have dramatic effects. If anti-corruption laws are strengthened and publicised, if sound and proven procedures and good-quality documents are adopted, if procurement competence is increased by training and career development, and, if everyone knows that the government is serious about enforcing honest and fair practices, change will come.

It must be widely understood that corruption in public procurement will not be tolerated, and that guilty parties will be punished. Experience shows that although this approach may not stop all procurement corruption, it will definitely curtail the problem. Corrupt procurement is not inevitable. It can be cleaned up, and when it is, the public is the great beneficiary.

### "Commissions" as a cover for corruption

As George Moody-Stuart has made clear, the greatest single cover for corruption in international procurement is the "commission" paid to a local agent. It is the agent's task to land the contract. He or she is given sufficient funds to do this without the company in the exporting developed country knowing more than it absolutely has to about the details. This creates a comfortable wall of distance between the company and the act of corruption, and enables expressions of surprise, dismay and denial to be feigned should the unsavoury acts come to the surface. The process also enables local agents to keep for themselves whatever is left of the handsome commissions after the bribes have been paid. Much of it may have been originally intended for bribing decision-makers but none of it, of course, is accounted for.<sup>14</sup> This gives rise to practices of kick-backs all along the line, with company sales staff effectively helping themselves to their employer's money.

Obviously, if commissions can be rendered transparent it would have a major impact on this source of corruption.

In 1995, an unsuccessful attempt was made by the Parliament of Nepal to force disclosures in international procurement exercises.<sup>15</sup> Much more promising have been the more recent efforts in Malaysia, Korea, Colombia, Argentina, Greece and Italy, where an "islands of integrity" approach has been developed by Transparency International.

Under this gradualist approach, the bidders for specific projects are being brought together and encouraged to enter into an "Anti-Bribery Pact" with the Government, and with each other. Each bidder agrees not to pay bribes and to disclose the commissions paid, and for its part, the Government pledges to take special efforts to ensure that the exercise is not tainted by corruption. In this way, the rules change for everyone and at the same time; and the players are, themselves, a part of that process of change. Once the selected contracts have been offered, the bidders continue to meet to monitor developments and build confidence for future exercises of a similar nature.

#### Success fees and "grand corruption"

The paying of a bribe to somebody is not a crime, a local agent might say. I don't need anything unless the sales (or project) goes ahead; but if it does, then include 5% in your price for me. Only that 5% may be 10%, 15% or even 20%. On an order of \$100,000 worth of goods \$10,000 may not ring any alarm bells; but what if the order is for \$100 million? These "success fees" lie at the heart of grand corruption.

*George Moody Stuart,  
Conference on Corruption, Democracy and  
Human Rights in West Africa, Cotonou,  
September 1994*

14 Consulting engineers in Tanzania are convinced that the local agents in their own country are the prime beneficiaries of the commissions, with much less going to decision-makers than overseas principals imagine. Discussions with FACEIT (Front Against Corrupt Elements in Tanzania), August 1995.

15 The Nepalese Parliament was reportedly informed by the country's Ministry of Finance that such a move would be opposed by the World Bank and some bilateral lenders, and so the Bill was withdrawn. When Transparency International protested to the

World Bank, it was informed that such was not the advice tendered by the World Bank from Washington. However, official sources in Nepal insist that such was the advice given to them, and that they acted on it only with reluctance. See TI Newsletter, September 1995; *Kathmandu Post*, 7 June 1995; advice provided from the World Bank headquarters to the World Bank office, Nepal of 27 February 1995. The World Bank has subsequently become much more supportive of these initiatives.

**Seoul's "Integrity Pact"**

In South Korea, the Seoul Metropolitan Government (SMG) has institutionalised the Integrity Pact concept developed by Transparency International, through a public-private partnership between the government and local NGOs. This was in response to a proposal from the People's Solidarity for Participatory Democracy (PSPD), the country's largest and most active civil society organisation.

Bidders submit the "Bidders' Oath to Fulfil the Integrity Pact" along with their bid documentation, and a relevant SMG official submits the "Principal's Oath". The terms of the Pact are made a special condition of the contract, and the whole process is overseen by a team of five Integrity Pact Ombudsmen, appointed by the SMG on the recommendation of civil society organisations. There are three series of public hearings. Once the contract has been implemented, the process concludes with an evaluation undertaken jointly by the SMG and civil society. Those who report corruption are both guaranteed protection and given a reward.

Key contents of the Integrity Pact include: (a) bidders refraining from offering bribes, gifts or entertainment to relevant SMG officials to influence a bid; (b) the SMG and its relevant officials pledging not to take bribes; (c) contracts being liable to termination and bidders liable to disqualification should there be a violation; and (d) no punitive action being taken against anyone who reports corruption from within their organisation.

The Pact was launched in three major project offices on 10 July 2000, and it will be extended to all offices in six months' time, after any necessary fine-tuning.

*Integrity Pact of Seoul, July 2000,  
Seoul Metropolitan Government*

A drawback has been opposition from some international lending institutions to any ad hoc arrangement for a specific project, the view being that the law must be changed across the board. This can present obstacles where a government has difficulty in persuading its Legislature to back serious anti-corruption efforts, and also where it may be beyond the capacity of the government machine to adequately police new arrangements, at least initially.

However, these problems have been largely overcome by making the Anti-Bribery Pact a voluntary one, and it has won encouraging levels of support from the private sector firms involved. Indeed, this may be the better approach.

Initial monitoring suggests that the innovation is working and that it is serving to significantly reduce corruption levels in the selected major contracts.<sup>16</sup>

**Areas of action for the international lenders**

Without doubt, the work of some international lending agencies has achieved much over the years, including the persuasion of reluctant governments to commit to public tender bid openings. Clearly, too, they could contribute even more significantly to anti-corruption reforms if they were to join in the push for transparency in commissions.

Although international lending agencies may be constrained, to some degree, by the constitutions which govern their operations, there are further steps which they may be able to take (some have already done so) to combat corruption. Transparency International argues that these measures

should include:

- ensuring that development assistance addresses corruption within the context of good governance programmes;
- reviewing procurement guidelines to ensure that the agency has adequate powers to combat corruption when it occurs in agency-funded transactions;
- invoking, without hesitation, these powers when corruption is detected and taking the necessary steps to have consultants and suppliers blacklisted who are found to have been party to corruption;
- examining modalities whereby disputes with consultants and suppliers can be settled through international rather than national dispute resolution mechanisms. For example, US mechanisms have often supported damage awards which are out of line with those of other countries;
- adopting a more pro-active approach in contract oversight and project management. Such an approach would include random (but regular) in-depth audits undertaken collectively where other lenders are involved (to prevent double claims being made), and timely, professional follow-up procedures for handling complaints about corruption;
- considering the feasibility of placing staff responsible to the agency in key positions within vulnerable borrowing institutions, to ensure timely auditing, to continue monitoring operations, and to help develop the financial management skills of local officials;
- developing a dialogue with a core of consultants who are committed to working in

<sup>16</sup> A detailed note on the process, including the documentation used, appears in the Best Practice compilation on the Internet

version of this Source Book: [www.transparency.org](http://www.transparency.org).

corruption-free environments and exploring their ideas on how such an environment can be brought about;

- reviewing internal checks on agency staff and consultants to ensure that any internal corruption is kept to a minimum (including monitoring the assets etc. of decision-makers and requiring disclosures of relationships with actual or potential suppliers: the agencies should “role model” the conduct they rightly expect from borrowers); and,
- investigating complaints from unsuccessful tenderers through internal agency procedures, rather than referring complaints to the government or the borrower of funds.

### Using contracts to counter corruption – A New York case history<sup>17</sup>

For generations, New York City suffered from endemic corruption and racketeering in its construction industry. When state and federal prosecutors, working with the FBI and the New York Police Department, undertook a series of very successful criminal prosecutions against the Mafia during the 1980's, virtually every indictment included allegations that the Mafia was profiteering from the City's construction industry through extortion, bribery, bid rigging, labour racketeering, fraud and illegal cartels. Despite the success of these prosecutions and the imprisonment of dozens of Mafia bosses, corruption seemed to continue unabated.

#### External review of major public contracts

Recently, a West African Minister of Finance, felt uncomfortable that he was being asked to sign off on contracts about which he knew too little. As Minister of Finance he could sign off on the availability of funds, but he felt uneasy about effectively approving the substance of each particular deal.

To remedy this, he decided to institute an informal external review process. An international firm was contracted to look quickly at the overall substance of each major contract, checking on the basis of “value for money” and raising any relevant queries. The process has resulted in marked reductions in cost for a number of contracts, and even the cancellation of some projects which were found to be wholly unnecessary or undesirable. The process has been found to be swift, inexpensive, and highly cost-effective. The success of his initiative has led to its being adopted in other countries.

*Confidential discussions, 1999/2000.*

The problem was so severe that the New York State Legislature refused to provide billions of dollars in funding to the City's Board of Education for capital improvements to the City's crumbling school infrastructure, the largest in the nation with more than 1100 schools serving more than one million school children. State officials were convinced that a major portion of any moneys allocated to the Board of Education would end up in the hands of the Mafia, or be wasted on bribes and fraud. In order to overcome this impasse, the City agreed to the creation of a new City agency, the School Construction Authority (SCA), with a very active and well funded office of Inspector General to ward off Mafia influence and to protect this critical investment in the school system. In 1989, the SCA was given \$5 billion for new construction and major repairs; the budget of the Inspector General was just over \$2 million annually (i.e. less than 0.05 per cent of the total).

The SCA's Inspector General set about tackling the corruption and racketeering endemic in school construction. Significantly, this was accomplished without new legislation and without spending millions of taxpayer dollars on costly preventive measures. The Inspector General used existing state law and the concept of civil contract to accomplish its goals, together with simple monitoring and oversight measures to insure compliance. This effort succeeded beyond anyone's expectations.

For example, the Inspector General redrafted the standard bidding and contract forms to include requirements for:

- full disclosure of ownership and performance history by each bidder (subcontractors as well as contractors);
- disclosure not only of details of previous arrests and convictions, but also of the payment of any bribes, participation in any frauds or bid rigging, and association with any organised crime figures;

<sup>17</sup> Based on a paper by Toby Thacher, New York, prepared for a TI procurement workshop held in Abuja, Nigeria, 2000, and after

discussions with Kevin Ford.

- commitment to a code of business ethics by each bidder; and
- certification that all this information was true and correct, as well as an acknowledgement that it was submitted for the express purpose of inducing the SCA to award a contract.

The SCA's standard contract included a rescission clause making the contract subject to termination by the SCA on severe terms if the contractor provided false information in its bidding documents. In practice, if a contractor was found to have lied in his bidding documents, or to have engaged in bribery or fraud during the execution of the contract, the contractor faced not only the termination of his contract, but also a legally enforceable requirement that he forfeit any and all moneys received for work already performed as liquidated damages. In addition, he and his company would be disqualified from receiving any SCA contracts in the future.

The information supplied by each contractor was subject to careful scrutiny by the Inspector General's Office, which also performed extensive background checks. Whenever concerns arose, a bidder or contractor was summoned to the Inspector General's Office to answer questions under oath. Any contractor who refused to cooperate was subject to the termination of his contracts and disqualification from future work. Any who lied under oath were, of course, liable to prosecution for perjury under the existing criminal law.

Contractors were required to make and maintain records regarding the work performed for the SCA for a period of three years after the completion of any contract. Such records were subject to audit and inspection by the SCA. If an audit disclosed over-pricing or overcharging of any nature and this exceeded one half of one-percent of the contract billings, then, in addition repaying the overcharges, the contractor had also to pay the reasonable costs of the audit.

Within the first five years of the SCA's existence, several hundred contractors were barred from bidding on SCA contracts. Several dozen contracts were terminated, and contractors forfeited many millions of dollars as a result. All of this was achieved through the ordinary civil law process with very few court challenges. In addition, more than a dozen contractors were convicted of perjury as a result of false information supplied to the Inspector General.

More importantly, law enforcement officials intercepted conversations among Mafia members complaining that this process was effectively denying them access to SCA contracts. And best of all, the pool of available construction firms was increased substantially with the addition of law abiding and competent contractors who had formerly declined to bid on school construction work because of the prevalence of corruption and racketeering. This increased competition resulted in further reduced costs and even higher quality work overall.

Finally, in suitable cases, where a contractor was found to be unqualified to bid on SCA work or was liable to have his contracts terminated for reasons of integrity or character, the contractor was given an option. He could drop out of competition for SCA work, or he could agree to continue bidding on, and performing SCA work, subject to close monitoring and oversight by an Independent Private Sector Inspector General (IPSIG). The IPSIG, one of a number of qualified specialist firms with expertise in forensic accounting, law and investigation, would be selected by and report to the SCA's Inspector General. However, all of the IPSIG's fees and costs would be paid by the contractor.

The advantages in this approach are considerable, and the fact that the reforms have been shown to be effective is reason enough for others to look very closely at this "contract model" approach, and to consider adapting it to their own circumstances.

## Questions of timing – and of the involvement of outsiders

The effects of normal anti-corruption legislation can usually be strengthened by adding two elements: the timing of actions and the involvement of “outsiders.”

Timing is crucial. Most public servants cannot say “yes,” but they can say “no,” “perhaps,” or nothing at all. Unreasonable postponement of important decisions is usually the most visible indicator that a corrupt deal is in the making. Procedures, therefore, should have strict calendars (which although strict, still recognise that procurement is often subject to frequent but legitimate delays). If the calendar is not respected, procedures should provide for an alternative decision-making process to make “blackmail by procrastination” unrewarding.

Since the partners to a corrupt deal are not protected by law, such deals can take longer to put together than regular business transactions. Dummy companies or money-laundering channels require time to set up. The arrangements must be both invisible and deniable. Delivery of the bribe and counter performance have to be closely linked, because mutual trust is usually absent. In some cases, officials want to build in elements of profits sharing. Sometimes two or three layers of “mediators” are built in to diminish the risk of exposure of the parties to the deal. Negotiations are delicate because, at any given moment, one of the parties may bail out and expose the whole scheme. All this takes time - time that an effective regulatory framework will not allow.

The role of “outsiders” is basically to hamper the creation of insider relationships of “trust” during the decision-making and implementation processes. Procedures should focus on keeping “outsiders” as “outsiders”, and not allowing them to be drawn into internal processes. Like external auditors, the “outsiders” should provide expertise combined with integrity.

Several measures are worthy of mention here:

- outsiders can assist in preparing bidding documentation (especially independent consultants with public reputations to defend);
- outsiders can participate in evaluation (adding an independent “audit” note of concurrence or otherwise);
- the contract-awarding committee should comprise persons of known integrity, not necessarily experts - with participation on the committees being a post of public honour and with the members’ own wealth being subjected to public scrutiny;
- the contract-awarding committee should not have advance knowledge of the particular projects for which their services may be needed. There should be more people on the list than will be needed at any one time. During the decision-making process the committee should be placed in a position where they cannot physically contact bidders individually (which may involve their remaining within a controlled environment, such as a hotel). If the committee cannot make a decision within a given time, a new session should be held with a committee of a different composition;
- the authority executing the works should not have a vote in the bid evaluation committee, but rather be available to the committee to answer questions: the same goes for any international consultant who prepares the bidding documentation;
- project implementation should be supervised by a consultant other than the one responsible for preparing the bid documentation;
- special procedures must close loopholes whereby artificially-created “cost over-runs” are met through the national budget, and not from a foreign loan;
- “cost over-runs” should only be accepted where supervision reports exist which iden-

tify the reasons for the higher costs at the time that these became evident. No ex post facto supervision reports should be accepted. This procedure makes the contractor responsible for timely reporting of the difficulties encountered.

None of this is a question of morality. It is directed towards undermining the reliability of corrupt deals, and maximising the risk to offenders of corrupt deals falling through or being disclosed.

### **Some indicators for assessing integrity in public procurement**

- Are efforts made to streamline bureaucratic requirements to the minimum necessary?
- Are all major procurements advertised in ways which bring them to the attention of the private sector?
- Is the process as a whole transparent?
- Are integrity tests conducted on officers in sensitive posts?
- Are the assets, incomes and lifestyles of officers in sensitive posts monitored?
- Are the rules for public procurement laid down in documents accessible to the public?
- Do the rules require open competitive bidding? With access by anybody? Or only those invited to participate?
- Are invitations to bid advertised so that they become known to all interested bidders?
- Does competition actually take place, or is this requirement overridden frequently?
- Are procurement decisions made by a Central Tender Board? Or by each administrative unit?
- Are procurement decisions made public?
- Is there a procedure to request a review of procurement decisions ?
- Is there an independent element in the procurement process as a means of ensuring compliance with laid down procedures?
- Can politicians over-rule the decisions of technical experts? If so, do they?
- Is the whole procurement process reasonably transparent? Or is it mostly confidential, and not subject to queries?
- Do the decision-makers (on procurement) stay in the same post for a long time, or are they rotated around?
- Are there any public audits of project performance as against original cost estimates? By internal officers? Or by an independent audit court?
- What happens when an Auditor-General or an audit court questions procurement decisions? Does the report go to Parliament? If so, what happens there?