

Working Paper

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Corruption and Public Procurement

Public procurement affects all aspects of people's lives and assumes a large share of government budgets. The acquisition of buildings and land by municipal and national governments, the construction of roads, the provision of health and education services, and the construction and operation of drinking water and sanitation systems are just a few examples of public investments that involve procurement. The Organisation for Economic Co-operation and Development (OECD) has estimated the value of government procurement markets worldwide to be US\$ 2 trillion annually.¹ Wherever such large quantities of money change hands, the risk of corruption is high.

People often refer to public procurement as being very complex and a technical subject. But this assumption should be challenged. Anyone can understand why it is important to introduce safeguards against corruption in public procurement. Everyone — from individual citizens to high level government officials — can play a role in ensuring tax payers' money spent on procurement delivers good quality services at a fair economic cost for all. The purpose of this paper is to raise awareness and guide interested individuals towards promoting greater transparency and integrity in public procurement.

Defining Public Procurement

Public procurement, also known as public contracting, is a multi-step process of established procedures to acquire goods and services by a government entity.²

It involves the full cycle from needs assessments through to the preparation of the procurement documentation, the awarding of contracts, the implementation and the final accounting of a completed contract. Public procurement is applicable to any government contract for goods, works or services, including for consultancies.

Given the measures and tools to prevent corruption, the term public procurement can also be understood and applied to all of the processes involved in issuing licence and permits, providing concessions and conducting privatisations.³

**Transparency International:
Advocating for Integrity in
Procurement**

At the international level, TI contributes to work on procurement regulations and procedures by multilateral development banks and organisations.

TI is part of the advisory group for the World Bank's pilot programme of country systems. TI has also followed up on the implementation of public procurement provisions included in international agreements (including the Paris Declaration and the UN Convention against Corruption).

Finally, TI has issued recommendations to improve the debarment system in the European Union and has contributed to strengthening anti-corruption practices in export credit agencies.

1. Understanding corruption in public procurement

In global policy circles, the importance of corruption-free procurement is uncontested. Numerous bilateral donors and all international organisations — including the OECD, multilateral development banks, the World Trade Organisation and the European Union — have emphasised the need to increase transparency and control corruption in procurement. The ultimate objective is to ensure the best impacts from the use of tax payers' money and the increased effectiveness of aid.

In the last few years, the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action⁴ have provided renewed focus on strengthening procurement systems at the country level in order to better deliver on development money being spent. The international community and developing countries have undertaken reforms that incorporate integrity as one of the main pillars for an effective country procurement system.

When low levels of integrity in public procurement lead to corruption, it can be characterised by a number of actions — from bribery, facilitation payments and collusion; to the violation of conflict of interest rules, bid-rigging, and trading of influence. In the case of bribery, public contracting is perceived to be more susceptible to corruption when compared to other areas of government, such as tax collection, the judiciary or public utilities.⁵

As in any other corrupt transaction, corruption in public procurement involves a series of actors who take decisions based on their own interests rather than the public good. Some of the most important actors involved include public officials who are responsible for procurement and the management of contracts; politicians who influence decisions at the planning and contracting stages; and bidders, suppliers, contractors and sub-contractors who are involved in competing for and delivering on contracts. Also, intermediaries who represent bidders, joint venture partners and private companies' subsidiaries can play a role in corruption. Not to be forgotten are the banks, financial centres and other financial intermediaries that facilitate corruption by processing the illicitly acquired funds.⁶

2. The cost of corruption in public procurement

The cost of corruption in procurement is difficult to measure quantitatively, if at all, due to the clandestine environment in which it takes place. Given the massive amounts of money spent on public contracts, however, no one doubts that corruption in procurement has an immense impact on the effectiveness of government investments. Transparency International estimates that damage from corruption can represent on average 10 to 25 per cent — and in the worst cases as much as 50 per cent — of a contract's value.⁷ Surveys at the country level equally suggest such a high price tag for businesses when it comes to corruption in procurement. In Morocco, despite positive reforms to the procurement system, recent calculations by industry experts suggest that corruption still costs the country about 5 per cent of the value of each contracted

purchase.⁸ In the Philippines, business insiders have speculated that this cost may reach up to 50 per cent.⁹

Yet corruption in public procurement is not just about money: it costs lives. This can happen when the execution of a construction contract is flawed leading to a building collapse, or when substandard or counterfeit medicines fail to attend to people's health needs. This has happened and can occur in both developing and developed countries. For example, the high death tolls as a result of the devastating earthquakes in China (2008), Haiti (2010), India (2001) and Turkey (1998) were partly blamed on alleged corruption in the construction of public buildings, including schools and hospitals.¹⁰

3. Corruption risks and responses

In most systems, procurement follows a set of formally established rules and procedures that should always be transparent and subject to effective controls. A procurement process, either openly competitive or otherwise, can be divided into five stages. Each faces specific corruption risks that can be responded to by following good procurement practices.¹¹

Needs assessment: This stage involves decisions about the scope, economic viability and environmental and social impacts of the project, and the corresponding budget allocation. Corruption risks at this stage are linked to the approval of unnecessary, low quality or overestimated purchases or investments. These actions are aimed at inducing demand in order to favour a particular company or individual and, on occasion, may even be socially and/or environmentally damaging. Such problems often arise as the result of conflicts of interest on the part of government officials involved in the procurement process. Their decisions may respond to previous political commitments, reflect undue influence by the private sector, or be made based on their plans to leave public office and enter the private sector (i.e. the 'revolving door' phenomenon).¹²

Best practices to avoid these risks recommend providing extensive access to information — including project feasibility studies that cover all phases of the decision-making process — and facilitating discussions with project stakeholders (and particularly with affected communities) using public hearings or other consultation mechanisms (see side bar). Another good practice is to ensure the transparency of the selection of consultants responsible for the feasibility studies and to introduce ethics provisions. Such stipulations should help to ensure that selected consultants are free from conflicts of interest and are independent from political pressures. Measures to promote the integrity of consultants may include professional codes of conduct (such as for engineers, accountants and lawyers) and the inclusion of related provisions in any signed contracts.

Preparation: On the basis of the project review and approval process, the contracting authority is expected to develop specific technical designs, prepare a proper procurement plan, select the appropriate procurement method under the law, prepare bidding documents and announce the call for bids. Corruption risks are often associated with consultants preparing a design that favours a particular bidder, issuing bidding documents with biased or inaccurate technical

Preventing Corruption through Public Hearings in Argentina

Along with several municipal authorities *Poder Ciudadano* (www.poderciudadano.org.ar), TI's national chapter in Argentina, has organised public hearings to increase credibility and prevent corruption in public procurement.

At the public hearing, the responsible authority convenes citizens, businesses, experts and representatives of the opposition; presents the details of the project and the procurement provisions; and enables the participants to express their objections and suggestions.

These recommendations are to be taken into account and incorporated where appropriate in the procurement process.

Corruption and public procurement

Monitoring Procurement with Integrity Pacts

Developed by Transparency International, an Integrity Pact (IP) is an agreement between a government agency and all bidders for a (public sector) contract, where mutual rights and obligations are established so that neither side will pay, offer, demand or accept bribes; collude with competitors to obtain the contract; or engage in such abuses while carrying out the contract.

Sanctions are established for breaching an IP. A major feature of the IP is the role of an independent external monitor who acts under the umbrella of civil society to ensure compliance with commitments by all the parties. The IP has been particularly useful for monitoring major public infrastructure projects around the world.

This tool has been successfully applied in more than 15 countries in the last 10 years, in all sectors and all types of contracts. Some examples of how the IP has been used include to monitor the contracts issued for the new Schönefeld Airport in Berlin, Germany (€2.4 billion project); nearly 100 contracts worth approximately US\$ 30 billion in different sectors in Mexico; local government contracts in 20 Districts in Indonesia; 60 contracts in Colombia; and a series of contracts issued by 39 state-owned companies in India.

Lessons learned show that IPs can increase the trust of bidders and citizens in credible and 'clean' procurement processes, reduce complaints, save money on contract awards and help deliver contracts' results in time and within budget.

specifications, developing award criteria that make competition impossible, and/or improperly using exceptions to open competitive bidding.

Based on good practice, preventive measures at this stage can include the appointment of staff with sufficient technical capacity and resources to oversee the process; the mandatory completion by all staff of a conflict of interests register;¹³ transparent procedures to select design consultants to ensure their independence; public access to information on the final designs; public access to the bidding documents and an organised process to collect feedback on them; and independent external monitoring by civil society of the process, such as through the use of Integrity Pacts (see side bar).

Contractor/supplier selection and contract award: This stage includes providing clarifications to interested bidders, the submission and evaluation of bids, and awarding and signature of the contract. The most common corruption risks involve the sharing of confidential or privileged information with a bidder during the process to grant an advantage over other bidders; biased or delayed application of evaluation and award criteria to benefit a particular bidder; the prevalence of conflict of interests among members of the awards commission, lack of sufficient information on the award decision (in order to avoid complaints); and/or changes to basic elements of the proposal when signing the contract with the successful bidder.

Many measures can be taken to prevent corruption at this critical stage of the procurement process such as by ensuring all bidders receive exactly the same information, including which bids were submitted and their total cost; organising an evaluation of the bids through a committee with relevant technical capacities and bound by a code of conduct; providing complete and timely documentation to bidders and the general public of all decisions taken during the selection process, including the compilation of a comprehensive evaluation report; and putting in place effective and independent complaints and appeal mechanisms.

Contract execution: In this stage the 'contractor' or 'supplier' that has been awarded the contract provides the goods or performs the works or services as agreed, under the direct supervision of the contracting authority or an outsourced consultant. Payments are disbursed following the supervision of the process. The most frequent corruption risks include poor quality or defective work, or the failure by consultants and/or officials to report that goods or services do not comply with the specifications. Other risks are the issuance and approval of unjustified 'change orders' that modify the scope of the contractor's obligations or increase the cost of the contract, and the requirement by officials of the contracting authority that bribes be paid in order to process payments for the contractor.

Good practice recommends establishing an effective control system including unannounced visits to the project site involving civil society as external monitors, if possible together with project beneficiaries and/or local communities. The involvement of these stakeholders can help to check whether there has been compliance with the contract terms and specifications and to detect and report corruption 'red flags' (see side bar).¹⁴ Another measure is to fix a cap for contract changes (i.e. 15 per cent of the contract's value) above which supplementary authorisation would be needed, for example by an evaluation committee. Also,

strict rules for contract payments should be established and set out in a clear and agreed process. Finally, complete, timely and publicly available information should be provided on decisions taken by the contracting authority during the execution of the contract.

Final accounting and payment: Once contract execution ends, the contract's final accounting and payment happens under the responsibility of government staff. The main corruption risks are associated with the acceptance of false accounting or cost misallocations, fraudulent or duplicate invoicing for goods and services, or false certification of the project's successful completion.

Good practice recommends ensuring that staff members responsible for the final accounting of the contract have not been involved in any of the previous stages. Third party involvement in the verification of the final deliverables of the project is suggested. It is also useful to conduct performance audits, which compare the original estimated costs and benefits with the real ones at the end of the project. Major discrepancies may be signs of corruption. The reasons should be investigated and the responsible officials should be held accountable. Finally, both financial and performance audit reports should be made publicly available.

4. Effective and transparent procurement systems

The modern view of procurement has moved away from considering it a basic procedure for the expenditure of public funds.¹⁷ The volume of money spent through procurement and the impact it has on development requires that procurement be considered a core part of any government programme. It should be strengthened as part of a country's public financial management system and service delivery chain.

Individual procurement processes as described in the previous section require an enabling environment to be developed in an effective and transparent way. These conditions are embodied in the overall procurement system of individual countries. A well-structured procurement system should follow the principles of *economy and efficiency*, so that public expenditure ensures value-for-money; *competitiveness*, so that equal opportunities are guaranteed for all eligible bidders (and thus real cost competitiveness results); and *transparency*, so that public oversight and equal access to information is provided.

Following these principles, a number of elements are needed for the effective operation of a procurement system.

Legal framework and implementing regulations: For a procurement system to meaningfully reduce corruption, rule of law is essential.¹⁸ Provisions of international anti-corruption conventions, like the United Nations Convention against Corruption (UNCAC), regional agreements and the OECD Anti-Bribery Convention,¹⁹ together with other international guidelines based on best practices,²⁰ set the general parameters for shaping national legislation on procurement.

Legislation and implementing regulations should cover the full scope of procurement undertaken by different bodies using public funds. They should

Beyond the Integrity Pact: Innovative Approaches by TI National Chapters

TI's national chapters have conducted procurement monitoring efforts that have differed somewhat from the method employed by Integrity Pacts.

In Serbia and Pakistan, for example, national chapters have used their own monitoring and reporting on procurement projects to attract media attention and wage public complaints.

National chapters in Georgia and Guatemala and Serbia) have drawn on public information about procurements, made available either electronically or through freedom of information acts, to monitor contracts. Other national chapters have opted to set up civil society observatories of public works procurement (Dominican Republic and El Salvador), or to provide oversight over contract award committees (Kenya).

These efforts have not been without their challenges. Access to timely and reliable information is frequently the biggest obstacle faced in this work. Another impediment has been to secure in advance the willingness of public authorities to provide the information and take on the recommendations resulting from monitoring effort(s).

Using Media to Engage Citizens in Procurement

Increased openness of the contract selection and bidding process can create an important change of public perceptions and citizens' participation in procurement decisions.

In Bolivia, as highlighted in TI's Global Corruption Report 2009, the contracting out of state-owned firms to private companies was done live on television, with the bids being opened publicly for all to see.¹⁵

Since 2007, radio has been used as the medium in Ghana to broadcast public hearings on audit reports. These reports have been produced on public procurement processes that have failed to follow existing national laws and procedures.¹⁶

Corruption and public procurement

Providing Transparent Information: The CoST Initiative

The Construction Sector Transparency Initiative (CoST) is a multi-stakeholder effort to ensure access to information in public sector construction projects. The objective is to make them more transparent and accountable, and ultimately reduce mismanagement, waste and corruption.

CoST involves governments, the private sector and civil society and has been piloted over a two-year period in seven countries: Ethiopia, Malawi, Philippines, Tanzania, the United Kingdom, Vietnam and Zambia.

CoST provides for the disclosure of information related to the cost and quality of government-funded construction projects in the public domain during the preparation and construction phases.

For more information on CoST, see: www.constructiontransparency.org.

determine the acceptable procurement methods — favouring open public bidding as the preferred option for all contracts above a certain threshold; establishing rules for advertising, submission, receipt and opening of tenders that guarantee participants equal treatment and minimum time conditions to prepare their bids; and requiring that rules for participation, technical specifications, evaluation and award criteria are clear, impartial and established in advance. Rules and regulations should also provide for effective complaints and appeal mechanisms.

Institutional structures: The procurement system must be properly developed in conjunction with the country's public financial management structures so that national budget planning and disbursement processes support the effectiveness of procurement operations. At the same time, the procurement system must be effectively managed so that responsibilities for policy and regulation, advising contracting entities, handling procurement information and statistics, and overseeing performance monitoring are effectively carried out.²¹ The introduction of tools such as e-procurement contributes both to the effectiveness and transparency of the system.

Access to information: Data systems should be in place for the collection, analysis and dissemination of information on procurement processes, including the decisions taken and money spent. The decentralisation of procurement should not be an excuse for poor information keeping, particularly on statistics. The technologies in use should facilitate broad public access for increased transparency and accountability. Technical information needs to be presented in a simplified way in order to be accessible to civil society and the broader public (see side bar). Information that is classified as 'confidential' and 'not accessible' should be defined as narrowly as possible.

Capacity development: The system should ensure that the different actors involved in procurement processes are well equipped to perform their role. This requires the professionalisation of government officials (especially those at the local level) and businesses involved in procurement, through active training, information sharing and guidance. The aim should be that they interact effectively in the procurement market with no major constraints that could limit the participation of the private sector.

As important is the capacity development of civil society so it can take part in improving procurement processes and advocating for the strengthening of procurement systems. Access to public information is key, but the capacity development of civil society, with adequate resources for it, is the necessary complement. Given the high numerical value of contracts and the numerous procurement processes in any one country, training and the sharing of know-how with communities is essential if they are to be engaged, aware and effective.

Control and auditing systems: Internal and external control and auditing processes serve as fundamental deterrents to corruption in procurement. They should ensure proper follow up, so that there is no impunity when mismanagement is uncovered. Penalties for fraud and corruption should be clearly established and enforced.

Appeals mechanism: There must be an effective review body or authority that handles complaints and which has the sufficient procurement expertise and capacity to enforce remedies. The body should be independent from those agencies in charge of regulation, procurement operations, auditing and oversight.

Anti-corruption measures: A procurement system that is effective in deterring corruption should be supported by mechanisms that can prevent, detect and sanction corruption (see side bar). Criminal laws should include provisions on fraud, corruption, collusion and conflicts of interest. Effective enforcement mechanisms should be in place, including debarment.²² Sanctions ultimately serve both as a punishment for wrongdoing as well as a deterrent for future wrongdoers.

On the preventive side, many of the strategies described previously as 'best practices' can be used to combat corruption before it begins. In general, the involvement of civil society as a third party to either monitor procurement or support advocacy for procurement reform is a powerful resource. The increased use of e-procurement processes can help in this area. Finally, if problems arise, mechanisms are needed to facilitate the reporting of corrupt behaviours, such as whistleblower protections.

Advocating for Reform

TI's national chapters have used their experience and knowledge gained from procurement monitoring and research to conduct evidence based advocacy for legal and procedural reforms.

- 🌐 They have helped shape procurement laws in Pakistan, Serbia, Nicaragua and Indonesia.
- 🌐 In Armenia, some of the national chapter's recommendations were included in the National Strategy on Procurement Reform (April 2009).
- 🌐 In Germany, the national chapter has advocated for the strengthening and use of the country's debarment system.
- 🌐 In Bulgaria, research into corruption risks that were identified through a sample of finalised procurement processes has been used to advocate for procurement reform.

Corruption and public procurement

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To learn about TI's efforts on combating corruption in procurement, visit: www.transparency.org/global_priorities/public_contracting.

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- ¹³ A register to ensure that ad hoc conflicts of interest are made transparent so that decision-making is not compromised. See 'Recommendations of the Council on Guidelines for Managing Conflict of Interest in the Public Service'. www.oecd.org/dataoecd/17/23/33967052.pdf.
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- ¹⁸ World Bank research shows that countries that tackle corruption and improve their rule of law can increase their national incomes by as much as four times in the long term and child mortality can fall as much as 75 per cent. See <http://go.worldbank.org/4TGCU32GX0>.
- ¹⁹ OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. For more information on anti-corruption conventions see: www.transparency.org/global_priorities/international_conventions.
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- ²¹ In many countries a specific body has been created to undertake these responsibilities. Even if it is not a separate authority, these functions should be assigned and ensured that there is appropriate coordination in their performance and independence in the regulatory role.
- ²² Procedure where companies and individuals are excluded from participating on procurement processes due to unethical or unlawful behaviour. Recently an important cross-debarment agreement was signed amongst major multilateral development banks.

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Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business and civil society to develop and implement effective measures to tackle it. For more information go to: www.transparency.org

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