

EFFICIENCY IN PUBLIC PROCUREMENT



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PUBLIC PROCUREMENT IN SERBIA A Decade in Two-and-a-Half Years

Development of the public procurement system in Serbia - results

The importance of public procurement is growing in the European Union countries since its share in the Gross Domestic Product (GDP) of the EU countries has been steadily rising and has reached 16%¹, while improvements in legislation and its implementation have resulted in savings of 30%².

The experience of the countries in transition which joined the European Union in May 2004 has shown that efficient enforcement of public procurement legislation is a considerably more important and difficult task than the formal adoption of EU directives. It turned out that many of the new member countries had simply copied down directives and thereby formally fulfilled requirements while not possessing the needed capacity to implement them effectively, which became quite evident problem after accession the EU. For this reason, important criteria in evaluation of the progress in upgrading public procurement systems of the future candidates for membership in EU would be their capacity to implement legislation.

During the past two-and-a-half years, Serbia has crossed in the field of public procurement much of the ground traversed in the '90s by the ten countries which joined the European Union in May 2004. An analysis by SIGMA³ expert P. Blomberg shows that it is possible to identify three phases in the reform of the public procurement system in the transition countries⁴.

1) Bertrand Carsin, Director, Public Procurement Policy, Internal Market Directorate, European Commission, Third Conference of the Public Procurement Network, Ljubljana, March 2005.

2) Ibid

3) SIGMA (Support for Improvement in Governance and Management) is a joint initiative of the OECD and the European Union aimed to help countries in CEE to modernise their public governance systems.

4) "Lessons learnt from a decade of procurement reform in CEEC's", paper presented at the regional conference in Ohrid, September 2004.

The first phase, which took place till the mid-'90s, was characterised by high inefficiency in spending of taxpayers' money, particularly in the area of public procurement. The number of enterprises which had the privilege of doing business with the state was highly limited and there was no true competition among them. The procedure of public procurement was completely non-transparent and unregulated and there was no institutional framework whatsoever.

The second phase in the development of the public procurement systems in the countries in transition, which lasted from the mid-'90s until the year 2000, Blomberg defined as "Towards European Integrations". This phase was characterised by the adoption of public procurement laws, the beginning of publishing of public notices in daily newspapers and official gazettes, an increase in the average number of bidders per tender and an increase of the number of bidders that won the tenders. In this phase, the public was much better informed about corruption in public procurement area and its negative impact, which resulted in much lower tolerance to it and in increasing demand for discipline in implementation of the law.

In this phase, candidates for membership in the European Union began to harmonise their domestic legislation with EU directives and to establish special public procurement bodies, whose task was to implement the new regulations. These bodies were aimed not just to bring domestic legislation in line with the EU directives, but to play a key role in the efficient implementation of the regulations. These bodies were also given increasing responsibility for monitoring of public procurement procedures. In this phase the regulatory framework was completed by the adoption of all necessary secondary legislation, intensive training programmes were organised and needed manuals and instructions were published aimed to inform widest range of procuring entities and potential bidders on how to implement the law provisions properly.

When these parameters of development are applied on system in Serbia, we can say that it has all characteristics that had public procurement systems in candidate countries in 2000. In concrete, the Serbian public procurement regulatory framework has been completed which means that all secondary legislation required by the Public Procurement Law have been adopted. Both institutions of key importance for the implementation of the Law - the Public Procurement Office (PPO) and the Commission for the Protection of Rights - are operative and have achieved significant results so far.

The enactment of regulations which are to a large extent based on European Union directives and the establishment of the two institutions in charge of the implementation of the Law resulted in significantly higher transparency of public procurements than was the case before the Law was adopted. At the moment some 77 per cent of all recorded procurements are realised through procedures that involve public notification, while before the Law was enacted no such obligation existed and a negligible number of public notices were published.

Transparency in the area of public procurement resulted in a much more intensive competition among bidders. In 2002 there were an average of 7.5 bidders per tender and in 2003 the figure rose to 8.5, while before the Law was enacted it was below three -

at that time the practice was either to collect three bids formally or in many cases simply to start to negotiate directly with familiar supplier, without any prior selection process.

Competition among bidders for winning contracts has resulted in much more favourable offerings for procuring entities including significant cutting of prices. Due to that considerable savings in public procurement has been achieved during the past two years since the Law has been in force. In 2002 the contracted prices were lower than estimated for 9% in average, while in 2003 the figure rose to 12%. In other words, in 2003 government paid 80 dinars for the same things it was paying 100 dinars in 2001, i.e. in two years expenditures for the procurement of the same types and quantities of goods, services and works were reduced by one-fifth, part of which is certainly due to the reduction of prices “inflated” by corruptive practices⁵.

We can conclude that in the area of public procurement, in the past two-and-a-half years (since mid-2002 to present), Serbia has traversed a road which the countries in transition took a whole decade to do (i.e. from the beginning of the nineties until 2000).

Evaluation of the public procurement system in Serbia by the PPO

The evaluations of the public procurement system in Serbia made by bidders and procuring entities generally mirror the evaluation of the Public Procurement Office, which is based on collated and analysed data on public procurement contracts awarded. The enhanced transparency of the public procurement system since the Public Procurement Law was enacted is reflected in the fact that around 77% of all recorded procurement contracts were awarded after procedures that include prior publication of the notices in the official gazette and newspapers. In the preceding period no such legal requirement had existed and a negligible number of notices had been published.

Increasing transparency in the public procurement processes has led to a huge rise in competition for contracts: in 2002 there were an average of 7.5 bidders per tender and in 2003 around 8.5, while the figure in the period before 2002 was below 3 – at that time it was customary to collect just three offers, and sometimes not even that - procuring entities would simply invite established suppliers and negotiate with them.

The increased competition for contracts has led to much more favourable terms for procuring entities and considerable savings achieved in the two years that the Law has been in effect. The savings are calculated as the difference between estimated contract value and actually contracted value. In 2002, these savings reached 9% and in 2003 no less than 12%. That means that items that government paid 100 dinars in 2001, it buys now for just 80! In other words, expenditure for acquisitions of the same types of goods, services and works dropped by one-fifth in two years and part of the savings certainly

5) The Public Procurement Law was the first anti-corruption act adopted after the pro- democracy changes that took place in Serbia in 2000. Although other important anti-corruption laws were adopted in 2004, such as the Political Parties Funding Law, the Prevention of Conflicts of Interest Law and the Free Access to Information Law, their implementation have poor results, while the process of establishing the bodies relevant for the laws implementation is still at the beginning. In this way the Public Procurement Law remains the only anti-corruption law with efficient implementation where institutions are fully operational.

come from cutting prices “inflated” by corruptive practices⁶.

Rising efficiency of the public procurement system was accompanied by the increasing efficiency of the Public Procurement Office. In a total of 62 workdays in the first quarter of 2005, a total of 2,755 opinions were issued – an average of 44 a day (Table 1, Graph 1).

Public Procurement Office efficiency

TABLE 1

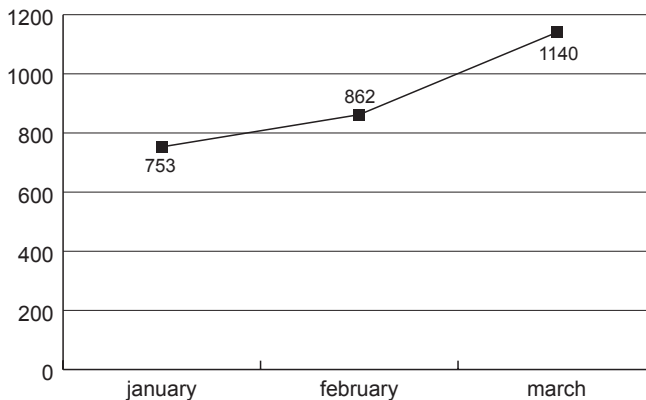
Q1 2005

	JANUARY 19 workdays	FEBRUARY 20 workdays	MARCH 23 workdays	TOTAL 62 workdays
Number of requests for opinions	753	862	1140	2755
Average processed per day	≈ 40 (39,63)	≈ 43 (43,1)	≈ 50 (49,56)	≈ 44 (44,43)
Number of telephone consultations	880	1024	1688	3592
Avg. telephone consultations daily	≈ 46 (46,31)	≈ 51 (51,20)	≈ 73 (73,39)	≈ 58 (57,9)
Procurement procedures monitored	16	8	16	40
Number of consultative meetings	22	15	38	75
Number of seminars	1	2	0	3

Number of requests for opinions

GRAPH 1

In January-March 2005

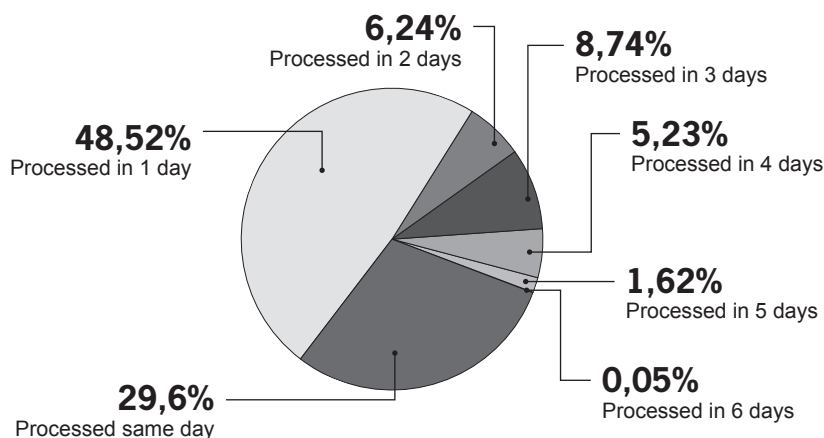


The level of efficiency in issuing opinions was very high – some 78.12% of all requests for opinions received were processed in less than two days (Figure 1).

6) The PPO was authorized to monitor regularity of the Law implementation by Amendments of the PPL that became effective on July 1, 2004.

Processing of requests for opinions in the Public Procurement Office

FIGURE 1

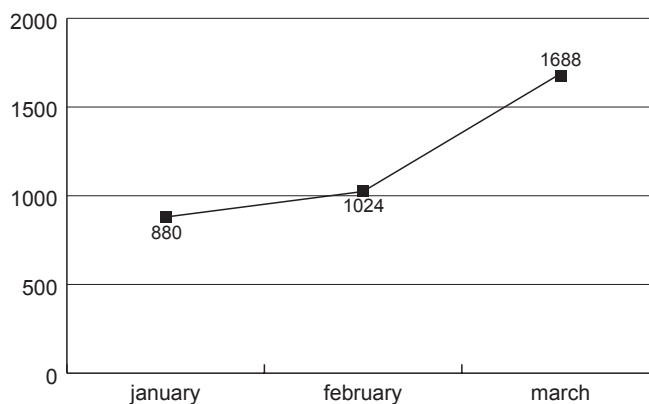


In this way the Public Procurement Office delayed procurement procedures only minimally, providing a significant contribution to the regularity of the process as well as to its efficiency (Graph 2).

No. of telephone consultations

GRAPH 2

In January-March 2005



In an effort to increase discipline, in the first quarter of 2005 the Public Procurement Office was involved in monitoring a total of forty procurement procedures:

- in nine cases the procuring entities themselves cancelled the procedures;
- in three cases requests for protection of the public interest were submitted to the Commission for the Protection of Rights;

- misdemeanour complaints were filed in two cases;
- in eight cases where contracts had already been signed, the Office forwarded cases to the authorized institutions;
- in thirteen cases the Office informed procuring entities about actions they should take in order to avoid breaking the Public Procurement Law;
- in two cases it was concluded that procuring entities had followed the Law and that no violations had been found, and
- three cases are pending, awaiting submission of requested documents by the procuring entities.

Based on the effects of the Law's implementation and the performance of the Public Procurement Office it can be concluded that Serbia has, in the past two-and-a-half years, accomplished progress in developing its system of public procurement equal to that it took a decade (from the early 1990s until 2000) to the countries in transition that joined the EU in 2004.

Development of the public procurement system in Serbia - future steps

The third phase in the development of the public procurement system in the countries that became European Union members in 2004 began when they joined the EU and is still in progress. This phase, which Blomberg calls "The Millennium and Onward – Accession to the EU", is characterised by the continuing harmonisation of domestic regulations with the EU one. Moreover, at the institutional level there is strong and capable Public Procurement Office that has advisory and monitoring role in the field of procurement. At the same time, the PPO has a key role in the process of harmonisation domestic regulation with the EU directives. The presence of a relatively high level of corruption in transitional countries justifies the strict regulation and strengthening of control in the area of public procurement.

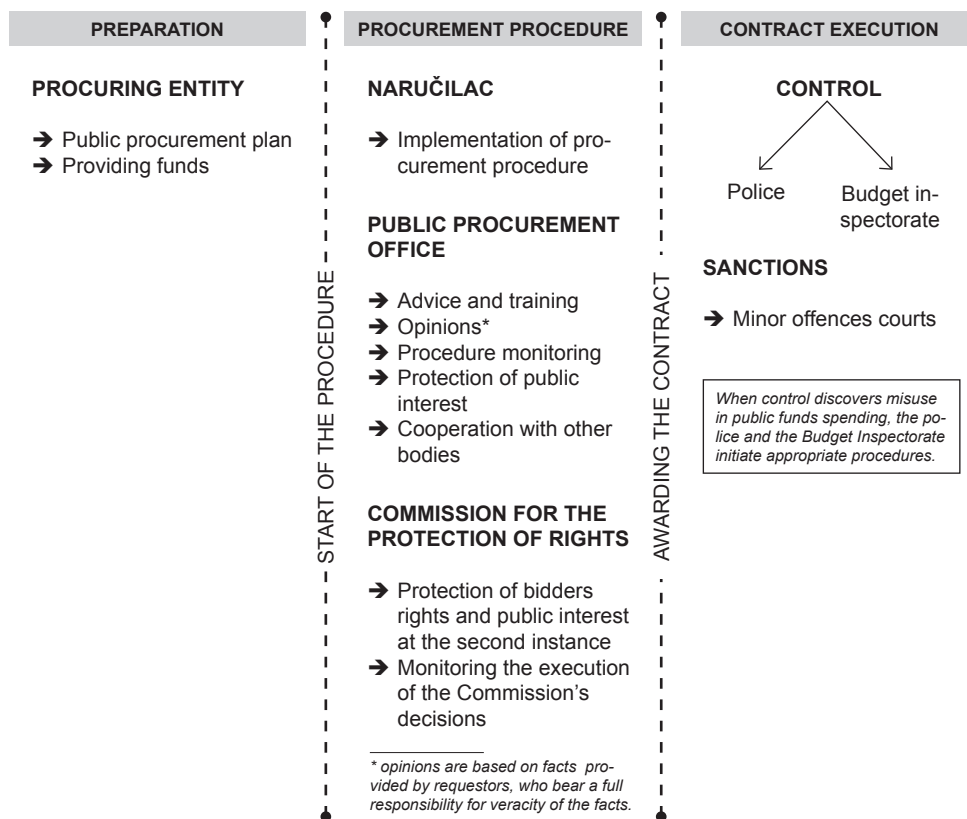
The major goal at this stage of the public procurement system development in Serbia is strengthening of the discipline in the implementation of the Public Procurement Law. The process seeks more active involvement of the relevant institutions as well as strengthening of their capacities.

At the present (third) stage of the development of the public procurement system in Serbia, the major goal is strengthening discipline in the Law implementation. The goal seeks for more active involvement of all relevant institutions in implementation of this task as well as continues upgrading of their capacities.

The Serbian public procurement system can be divided into three segments: the first segment is preparation for the public procurement, the second segment is public procurement procedure that is completed with awarding a contract to the most favourable bid and the third segment is execution of the contract. Each segment has different institutions responsible for an effective implementation of the Law as well as for monitoring and control of the Law implementation (Figure 2).

System of public procurement in Serbia

FIGURE 2



Procuring entity has a key role and a full responsibility in the segment of preparation for a public procurement. The first step that a procuring entity has to make in the process of preparing for the procurement is to adopt a procurement plan for the next fiscal year. Furthermore, the purchasing entity has to provide needed funds in accordance to the procurement plan.

Public procurement system in Serbia is decentralised, which means that procuring entities are able to define and specify their own needs on a best way. In practice, however, procuring entities have a tendency to exaggerate their needs that lead to unnecessary expenditure. Prevention of the excessive spending of taxpayers' money requires efficient control of the procuring entities' procurement plans by the Supreme Audit Institution (SAI).

The second segment of the public procurement system is the procurement process, i.e. the process of selecting the most economically favourable bid. The key prerequisite for successful procurement process is to ensure free competition and equal treatment of all interested bidders. Free competition will force bidders to compete for the contract

by trying to offer the most economically favourable terms to the buyer (i.e. procuring entity). That puts the buyer into the position to select the economically most advantageous offer, i.e. the bid with the highest “value for money”. Free competition, by the rule, results in more favourable offerings than limited competition. Therefore, the main goal of the Public Procurement Office is to ensure that goods, services and works for the government bodies and public companies are procured through a transparent, competitive procedure that would result in the best “value for money” i.e. in a most efficient use of taxpayers’ money.

According to the Law, in all cases where exist restrictions to a free competition among bidders and where restricted or negotiated procedure should be applied, the Public Procurement Office must make a prior assessment whether it is justified to apply those procedures instead of the open procedure and to issue its opinion in a written form. In this way, the PPO has been given a very important role in prevention of potential abuses by procuring entities in cases where competition is limited.

The Public Procurement Office has a preventive role in cases where procurement is divided into lots. The aim of this provision of the Law is to prevent fragmentation of procurement with aim to avoid open procedure that is characterized by highest level of transparency and competition. Namely, in many cases, purchasing entities try to divide high value procurement into several lots with value below a specific threshold that could be purchased by relatively simply procedure with limited competition. However, purchasing entity can not divide a procurement into lots without prior written permission from the Public Procurement Office.

The importance of the opinions and permissions issued by the PPO is confirmed by their constantly growing number. In the past two years over 15,800 requests for opinions have been processed. In the first quarter of 2005, the PPO received an average of 44 requests for opinions or permissions a day. All these requests were handled for 1.19 days on average, while 80% of them were processed in less than two days. In that way, the Public Procurement Office significantly contributes to the efficiency of the public procurement process.

A significant step towards strengthening of discipline in the public procurement was made when the Public Procurement Office was authorized to monitor the implementation of the Public Procurement Law. Following the authorization and newly adopted plan of monitoring, the PPO controlled eighty one public procurement procedures in the period October 2004 - March 2005. In sixteen cases, contracts have already been signed on and the PPO forwarded the cases to the authorized institutions (i.e. to the police and misdemeanour courts) to deal with them further. In twenty one cases, the procedures were still in progress and the PPO submitted requests for the protection of the public interest to the Commission for Protection of Bidders’ Rights, while in thirty one cases procuring entities were instructed on how to correct irregularities. In eight cases no irregularities were found, while three cases are still in progress, since procuring entities are expected to provide a complete tender documentation to the PPO.

The second important institution in the segment of awarding a contract is the Commission for Protection of Rights, which issues binding decisions on violations of the

Law in the procurement procedure. In 2003 the Commission received a total of 630 requests for the protection of bidders' rights that was 2.81% of all recorded public procurement contracts awarded in that period.

In the coming period, it is necessary to strengthen the capacity of the Commission in order to increase its efficiency in protection of bidders' rights. That requires the Commission should be established as an independent body with a full autonomy. Moreover, further improvements in procedure of protection of rights in public procurement are needed as well.

The third segment of the public procurement system is execution of a contract. The Public Procurement Law regulates the process till the contract is awarded to and signed with the most successful bidder. The authorities of the two institutions established by the Law - the Public Procurement Office and the Commission for Protection of Rights – ceased at the moment the contract is signed.

This means that one of the crucial segments of the procurement process – execution of a contract – remains outside the strict regulation. That opens space for a huge potential misuse in spending of taxpayers' money. The key role in controlling the execution of public procurement contracts should have Budget inspection and special departments in Ministry of Interior authorized to investigate financial crime, as well as Supreme Audit Institution.

Since SAI is not established in Serbia yet, the control of the contract execution segment is undertaken by inspectorates and the police. In future, it is necessary that the Budget inspection and police take a much more active role in the process of control of the public procurement contract execution, particularly of those contracts that are involving major procuring entities and high-value contracts. The experience of an efficient control "at the ground" - the reconstruction of Terminal Two of Belgrade Airport worth about 18 million euros – proved to had significant, widespread positive effects in terms of strengthening a discipline in the Law implementation and prevention of potential misuses. Furthermore, it is necessary to adopt the Supreme Audit Institution Law and to establish the Institution as soon as possible.

The complaints against procuring entities suspected of violating the Law which the Public Procurement Office submits to misdemeanour courts on the basis of punitive provisions of the Public Procurement Law have limited preventive effect, owing to the low level of the maximum fines prescribed by the Law, which often make up a negligible fraction of the total value of the procurement in question.

The crucial role in an efficient system of control of contract execution has judiciary to whom the police submit evidence of malfeasance in the public procurement contracts execution. Efficient prosecution of cases of budget funds misuse and high penalties would have potentially the best positive effect in respect to strengthening discipline in public procurement as well as in terms of prevention. For this reason, one of the key prerequisite for developing of an efficient and fair public procurement system in Serbia is that judiciary system in Serbia start to prosecute and process the cases of misuse in public procurement area on a much more efficient way.

Further upgrading and developing a fair, transparent and non-discriminatory public

procurement system in Serbia would strongly affect citizens' perception of corruption, since the public procurement is a synonym for so-called "large-scale corruption". Progress in curbing corruption in public procurement would improve overall perception of corruption in Serbia.

Public procurement is a field that international business community weights significantly when evaluate country business risks and risk of corruption particularly. Therefore, progress in curbing corruption in public procurement have a huge potential impact on the international business community's perception of corruption in Serbia which *Transparency International* rates by its annual Corruption Perception Index (CPI). A significant positive shift of Serbia at the CPI ranking list in the past three years – namely, in 2000 Serbia has 1.3 CPI points, in 2002 it has 2.3 points and in 2003 advanced to 2.7 points - was to the large extent, a result of establishing and developing a regulated public procurement system in 2002. The CPI is regarded as one of the leading indicators that is international business community using for measuring a risk of corruption and related business risk.

The development of a fair and efficient system of public procurement in Serbia

TABLE 2

PHASE	INSTITUTION	MEASURE
Preparations for public procurement procedure	Procuring entity	Internal control
	Supreme Audit Institution (SAI) *	Adopt Law on Supreme Audit Institution, establish SAI that would implement an efficient control of procuring entities
Public procurement procedure	Procuring entity	Internal control
	Public Procurement Office (PPO)	Monitors public procurement procedures
	Commission for the Protection of Rights	Amend the Public Procurement Law in order to secure: a) independency of the Commission and b) procedural improvements in the Law
Execution of the contract	Procuring entity	Internal control
	The police, inspectorates, Supreme Audit Institution, courts	Active involvement of police and inspectorates in control at the "ground", establishment of SAI, more efficient prosecution by prosecutorial organs and courts of malfeasance in public procurements, amendments of the Public Procurement Law in order to achieve a full harmonisation legislation with EU directives

* This institution still does not exist in Serbia

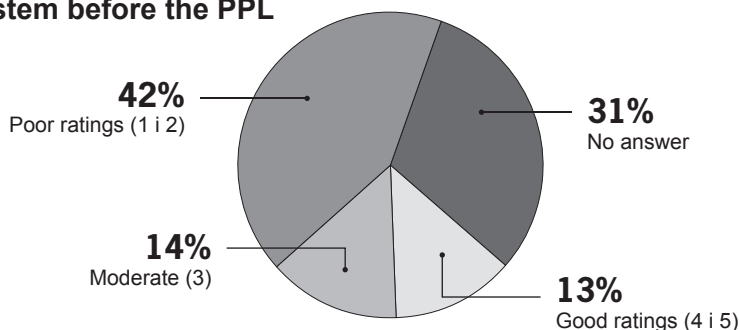
SERBIA'S PUBLIC PROCUREMENT SYSTEM EVALUATION

In March 2005, a hundred of procuring entities and a hundred of bidders were polled within a study of public procurement system in Serbia conducted by the Centre for Free Elections and Democracy (CESID), a non-governmental and non-partisan organisation and supported by the OSCE Mission to Serbia and Montenegro. CESID's pollsters used a set of 115 questions in face-to-face interviews. The sample was statistically and territorially balanced (97% local and 3% foreign tenderers). The sample was picked from a data-base of procuring entities and bidders compiled in 2003 by the Public Procurement Office.

In the period before the Public Procurement Law (PPL) was enacted, public procurement area in Serbia was rated poorly: purchasing entity rated the system¹ with average mark "two" (2,3) as well bidders (2,2) (see Figure 1).

Procuring entities ratings of the public procurement system before the PPL

FIGURE 1

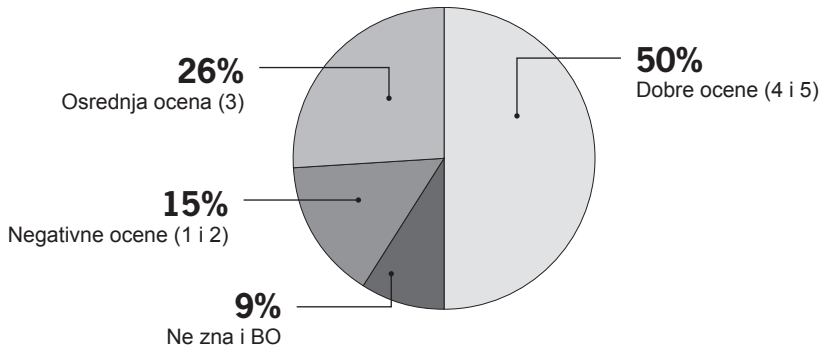


1) On a rising scale from 1 to 5

Ratings radically changed after the PPL was enacted. In that period, purchasing entities rated the public procurement system in Serbia with average mark “four”. Half of them gave “good” rating (4 and 5) and 26% gave “moderate” rating (3) (see Figure 2).

Procuring entities ratings of the public procurement system after the PPL

FIGURE 2



Bidders evaluated the public procurement system after the PPL was enacted by “three”. The system was evaluated as a “good” (4 and 5) by 31% of bidders interviewed and as a “good” by 30% bidders which means that the public procurement system got a positive rating by 61% of the total number of bidders interviewed (see Figure 3). The highest rating have transparency of the procedure and the number of firms competing for contracts (3.5 each), while the lowest ratings goes to simplicity of procedure and protection of domestic bidders (2.5 each).

Purchasing entities and bidders, in average, gave the lowest ratings to the simplicity of procedure and to the protection of domestic producers (2,5 each). The highest ratings have transparency of public procurement procedures (68% of bidders and 79% of purchasing entities perceive increased transparency in the public procurement processes) and increasing number of firms competing for contracts, i.e. increased competition (68% of bidders and 62% of purchasing entities perceive increasing competition).

Two sets of comparisons of the public procurement system could be made: comparison between procuring entities and bidders and comparison between the system before and after the PPL was enacted.

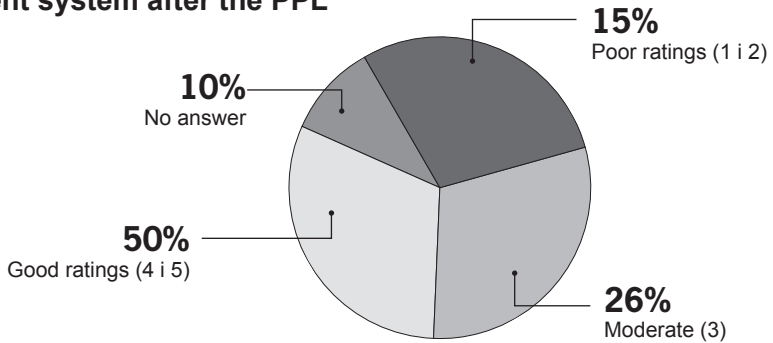
Differences in evaluation of the public procurement system between procuring entities and bidders are presented in Figures 4 and 5.

The second aspect of comparison of the public procurement system are its changes over time. The rating in the ‘90s was taken as a base index 100 and the present rating was expressed as an index change compared to the base index 100 (see Table 1 overleaf).

Overall index, taken as an average of all twelve indicators, of the present status of the public procurement system compared to its status in ‘90s was 141 for bidders and 153 for procuring entities. In other words, both interviewed groups agreed that the public procurement system improved by around 50 per cent.

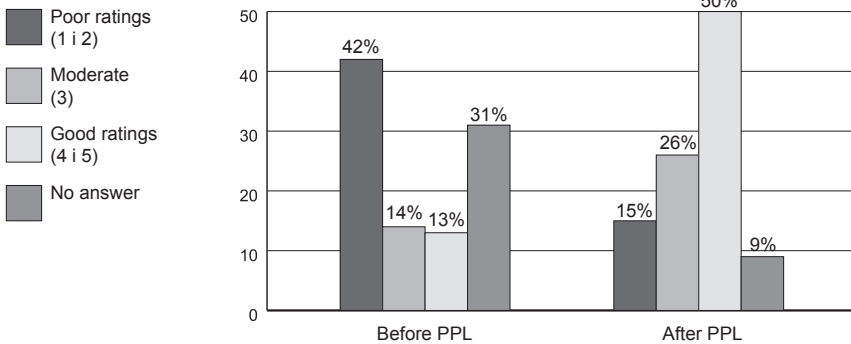
Bidders ratings of the public procurement system after the PPL

FIGURE 3



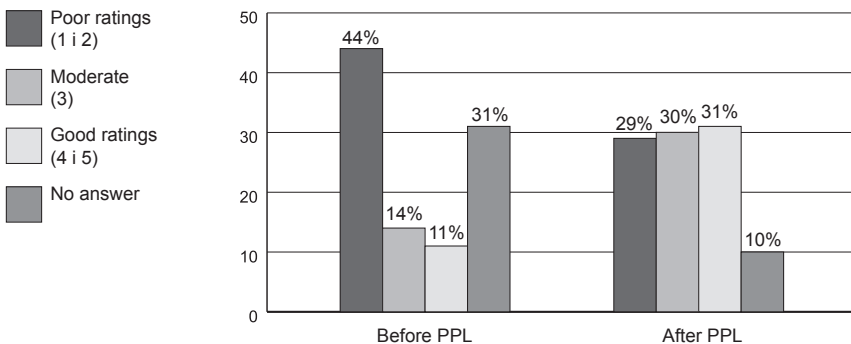
Procuring entities ratings of the public procurement system before and after the PPL

FIGURE 4



Bidders ratings of the public procurement system before and after the PPL

FIGURE 5



Public procurement system rating index

TABLE 1

Ratings in the '90s = 100

INDICATORS	PROCURING ENTITIES	BIDDERS
Transparency, openness	216	180
Harmonization with the EU standards	206	182
Procedures control	195	150
Intensity of competition	186	148
Fairness, equality of bidders	181	136
Presence of corruption	155	245
No. of firms competing for contracts	152	146
Efficiency, savings	150	135
Protection of the public interest	144	145
Discretion of public servants	140	129
Protection of domestic producers	131	93
Simplicity of procedures	69	92
TOTAL - AVERAGE	153	141

Procuring entities see progress on eleven indicators and find the only step back in respect of the complexity of the procedures. The bidders expressed optimism in respect of ten indicators and perceived a negative change in the two: simplicity of procedures and protection of domestic producers².

Respondents were particularly optimistic regarding the corruption issue - the index among bidders was no less than 245 (procuring entities 155), followed by transparency (bidders 216, procuring entities 180), than increased competition (procuring entities 186 and bidders 148), equal treatment of bidders and fairness (procuring entities 181 and bidders 136) etc.

Corruption in public procurement is on the decline. Comparing perception of corruption in public procurement in the '90s and now, there is a significant decline in the number of negative assessments among procuring entities from 40% to 15% and to a somewhat lesser extent among bidders from 47% to 39%.

Perception of the damage caused by corruption. Some 39% of the procuring entities polled and 43% of bidders perceive that corruption accounts for between 10% and 30% of the total value of public procurements. Such a high level of agreement between the two groups signals that the estimation is close to the real figures.

Perception of bidders relating to corruption in three segments of public procurement is that the highest risk is at the preparatory phase (39%), while procuring process and execution of the contract are equally risky (30%). That means that 70% of bidders perceive corruption in the two phases – preparation phase and execution of the contract

² In spite of the fact that the Public Procurement Law provides domestic producers an advantage of 20% points compared to the foreign ones.

– that are not regulated by the Public Procurement Law and are relatively weakly monitored and controlled by relevant institutions (budget inspection and police).

Assessment of the performance of the Public Procurement Office³ is based at opinions expressed by procuring entities that are the Office's chief clients and therefore also best informed about its work.

Some 88% of the requests for opinion submitted to the Office came from procuring entities, and just 12% from bidders⁴.

The integrity of the Public Procurement Office was particularly highly rated (with "four" or 4.2) (see Table 2) with 64% of the assessments being good, and only 3% of poor rating. Autonomy of work also received an average rating of "four" (3.9).

Efficiency of the PPO work was also rated with "four" (3.8). More than a half of procuring entities (51%) rated the efficiency of the PPO as a "good" (4 and 5), 31% gave a moderate rating and 7% poor. It could be said that procuring entities were not objective when rating the efficiency of the PPO, since the data from the PPO Annual Report⁵ provides a quite different picture. Namely, in 2003, the PPO processed a request for an opinion for of 2.66 days on average, while the figure for 2004 was just 1.19 days⁶.

Performance of the PPO

Rated by procuring entities

TABLE 2

	ASSESSMENT CRITERIA			
	Integrity	Autonomy	Efficiency	Overall*
Poor ratings (1 i 2) (%)	3	6	7	4
Moderate rating (3) (%)	13	10	31	26
Good ratings (4 i 5) (%)	64	28	51	56
No answer (%)	20	56	11	14
TOTAL (%)	100	100	100	100
Average rating (1-5)	4,2	3,9	3,8	3,8

*rated by procuring entities

Overall performance of the Public Procurement Office procuring entities rated by "four" (3,8).

The most significant positive effect of the Public Procurement Law is increased transparency - no fewer than 70% purchasing entities gave "good" ratings (4 and 5). Moreover, 57% of them rated as "good" protection of bidders rights, equality of bidders (i.e. non-discrimination of the PPL) was rated "good" by 59% of purchasing entities, while strong competition was recognized as "good" by 50% of them. On average, "good" and "moderate" ratings to the PPL were given by the 75% of the purchasing entities (see Figure 6).

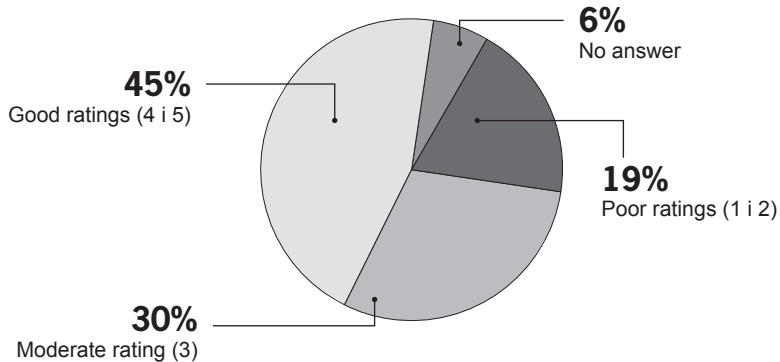
4) Annual Report to the Government of the Republic of Serbia for 2005.

5) Ibid.

6) The Public Procurement Law prescribes a seven days period.

Procuring entities rating of the Public Procurement Law

FIGURE 6



Among tenderers, all the criteria listed above were rated close to three. The average rating for transparency was 3.3, reviewing procedure 3.1 and competition 3.1

Regarding the steps that should be taken in future in order to improve the regulation of the public procurement in Serbia, purchasing entities and bidders have almost the same views and expectations. Both stakeholders of the public procurement system expect further strengthening of the discipline in the Law implementation. One-half of the procuring entities that were surveyed believe that more effort by the Public Procurement Office would result in significantly higher discipline, while two-fifths listed the Government and a quarter the police. No fewer than 69% of the procuring entities and 62% of the tenderers believe that more discipline in implementing the Public Procurement Law would be an efficient tool in curbing corruption in public procurement.

Development of control mechanisms in public procurement system is advocated by 85% of both procuring entities and bidders. Among them, two-thirds of both groups believe that better control would result in savings ranging between 10% and 30%.

It is important to take an advantage of the readiness of the both stakeholders to support the fight against corruption in public procurement. There is unanimous will (97% procuring entities and 91% bidders) to support institutions that are fighting against corruption in public procurement.

Moreover, both stakeholders are keen to support institutions that are involved into the process of curbing corruption in public procurement: in this effort the Public Procurement Office would have support of 89% of the procuring entities and of 79% of the bidders. Corresponding figures for the Commission for the Protection of Rights are 86% and 79%, the judiciary 81% and 70%, the Government 77% and 74%, and the police 71% and 60%, respectively.

Both purchasing entities and bidders expressed a high level of optimism about the strengthening of the regularity and discipline in the PPL implementation. Some 77% of the procuring entities and 59% of the bidders think that the discipline in the Law implementation will increase in the coming period, while 54% of the former group and 28%

of the latter one believe that the level corruption in public procurement will decline in the near future.

Although the Public Procurement Law was generally rated positively, vast majorities of both procuring entities (i.e.78%) and bidders (69%) think that the Law should be amended. Some 83% of the procuring entities and 69% of the bidders interviewed expect the Law to be simplified.

There is consensus among purchasing entities and bidders regarding future development of the Public Procurement Office - no fewer than 82% of the procuring entities and 79% of the bidders support further development of the Public Procurement Office's capacity and strenghtening its role in the public procurement system considering that issue very important. Moreover, about three-quarters of those polled believe that the independence and autonomy of the Public Procurement Office should be increased in the future.

3

THE ROLE OF NGO SECTOR IN THIRD PHASE OF PUBLIC PROCUREMENT SYSTEM DEVELOPMENT IN SERBIA

Civil society in a fight against corruption and situation in Serbia today

No effort aimed at fighting corruption that is exercised by state institutions, international organizations, the media and civil society associations can yield long-term success if the public, or at least a large percentage of it, is prepared to support these activities and take an active part in them. The citizens can support initiatives of this kind by joining anti-corruption programs, reporting cases of corruption that they encounter to the authorities, and by refraining from being involved in corruptive activities, even when such course of action is certain to postpone their own gratification. On one hand, the citizens are helping rid the society of corruption, but they are also becoming the subject of activities conducted by other entities. The citizens should be educated “to ask” why something needs to be done and which rights and options they have at their disposal, all in a bid to ensure that those who make decisions in their name are held accountable. Moreover, the citizens need to understand that they are the ones with the power in a democratic society, bestowed upon them through electoral and other rights, to control state officials who use public resources and “punish” those whose results or ethics have not met their expectations, while “rewarding” those that have behaved honestly and achieved success.

Non-governmental organizations (NGOs) are usually considered to be “more conscious” of the civil society that they originated from. Those are organizations whose programs and goals are closely linked with the promotion of public interest, as opposed to the advancement of personal goals of their members. They represent a varied lot, both in terms of their structure and modus operandi. Since NGOs do not draw their legitimacy from elections, they have to earn it solely based on the value of their work. Some activities that can be construed as useful and beneficial to the public include those that

recognize specific public needs, direct public attention to vital social issues, conduct an independent campaign, and represent a bridge of sorts between the citizens, public administration and international organizations. International and domestic experience seems to suggest that non-governmental organizations can act against corruption with great success by raising awareness about certain issues, conducting special campaigns, educating the populace, public servants, journalists and entrepreneurs, proposing new legislation and amendments to existing laws, pointing to good and bad examples in practice along with positive cases from countries facing similar problems, helping citizens that wish to fight against corruption, and overseeing the implementation of anti-corruption legislation.

Professional associations and organizations are also part of the civil society. These associations are better equipped to faster detect cases of corruption among members or discover typical cases of corruption that hinder their activities. Therefore, such organizations rely on internal regulations to maintain and improve the level of ethics among their members. On the other hand, these associations are indispensable in terms of education and promoting the fight against corruption both within own ranks and through contacts with their business partners and state institutions.

Non-governmental organizations operate under an entirely outdated legal framework in Serbia today, which does not prevent their establishment, but does hinder their activities. Foreign donations remain practically the only viable source of financing for them, while financial support from the budget and the private sector stays mostly symbolic. The status of professional organizations can be different. Some of them have received special powers through relevant legislation that allow for a more efficient implementation of internal regulations and sanctions for regulation breaches, whereas others struggle to enforce modest disciplinary measures because there is no mandatory membership nor sufficient public authority.

Civil society and public procurement

It can be said that the civil society played an important part in a fight to create an efficient and fair public procurement system thus far. Naturally, organizations that are in the business of fighting corruption deserve most of this credit, considering how unfair public procurement was registered as the most frequent and socially detrimental form of corruption, not only during the authoritarian rule of Slobodan Milosevic, but also in decades of the so-called self-management socialism that preceded it.

The beginning of this fight was marked with efforts to draw public's attention to corruption in public procurement along with studies that established the cause and the scope of the problem. Years of active lobbying by the civil society eventually came to fruition, as calls for a comprehensive regulation of the public procurement process in accordance with European standards and the best practices in the field finally resulted with the adoption of the Law on public procurement in July of 2002.

The law application is weak not only in Serbia but also in many other transition countries. Regulations, often adopted without criticism or public debate, and under

strong international pressure, frequently lack proper enforcement. The reasons for such state of affairs range from the inadequacy of adopted regulations to the absence of political will to apply the law, and the scarcity of human resources and available funding. Nonetheless, the adoption of the Law on public procurement should have been supported and non-governmental organizations, especially the Transparency Serbia, provided sizable contribution in that regard. They accomplished this by detecting weaknesses in certain articles of the law and proposing ways to rectify them, calling on state institutions to consistently apply the law, and informing the public about its importance. Aside from these types of controls, the non-governmental organizations also substantially assisted parts of the public service that administer the law. In view of the insufficient capacity of state institutions to inform a wide circle of users of the law with the changes it brings, the Transparency Serbia organized a number of seminars targeting the largest group that is supposed to implement the law – purchasers from local governments. After the law was amended in May of 2003 and the protection of bidders' rights improved, the Transparency Serbia focused its activities on educating those that could make the greatest contribution in terms of overseeing the implementation of the law – bidders from small and medium sized enterprises, journalists and local politicians. At the same time, the Transparency Serbia strives to continuously use its reputation and influence acquired through the fight against corruption to direct heightened public awareness to key issues in the field.

What can non-governmental sector do in third phase of public procurement system?

The starting point for future activities of the non-governmental sector must be drawn from previous experience. Such experience shows that the Law on public procurement is one of rare anti-corruption legislations that provided concrete and tangible results in practice, in spite of all obstacles on the way. These results manifested through budget savings (according to the Public Procurement Office report for previous years) as well as improved public sensibility towards cases in which prescribed legislation is not adhered to.

The second starting point represents experiences from third countries that have traversed much more of the path on which Serbia travels today and developing an understanding about the best practices to achieve fair and efficient public procurement, which have been taking shape on the dynamic international stage.

The non-governmental organizations can do a lot more in the future, and it would appear that their role in the current phase of the system development could be very important in efforts to accomplish the objective.

Monitoring law implementation

Monitoring of the law application is a field in which the non-governmental organizations are an indispensable asset. The citizens and the media might want to act in similar fashion, but they often lack the requisite expertise and analytical skills; state institutions entrusted with overseeing the law implementation are still not independent enough, thus making them vulnerable to undue political influence that can result in

biased or selective behavior; international organizations can offer useful suggestions, but their approach frequently resorts to generalizations without taking into account problem specifics of a particular location.

Monitoring the application of the Law on public procurement will be much easier in the future than in the past. It is also true that a large amount of information has been made public based on the law itself (for instance, publishing of public invitations to tender and publishing of decisions on selected bidders) or through the rising media interest in the matter. It is noticeable, however, that not all obligations are fulfilled in their entirety. Additionally, they are of little assistance in situations when the selection of bidders takes place in direct negotiations or through a restrictive procedure. In November of 2003, the law on free access to information, an important piece of legislation for the advancement of public interest, was adopted. The law obliges the “public administration” to allow access to information that they have at their disposal, regardless of who requests it. Exceptions, in cases where such an obligation does not exist, must be interpreted in a narrow sense, and in the case of information on planned or ongoing public procurement, they are almost non-existent. The circle of organizations that must act in accordance with this law encompasses in large measure the term “purchaser”, which has been defined in the Law on public procurement.

The implementation of the Law on free access to information officially began in mid-November, but it can be said that cases where state administration acts in accordance with prescribed regulations remain an exception rather than the rule. The Commissioner for information in the public interest, which should provide legal protection to those from whom the information was unjustifiably withheld, still does not have basic conditions to perform assigned duties. It should also be noted that the Public Procurement Office was one of the few state institutions that named a special administrator for access to information within a prescribed deadline and published the information about authorized officials on its Internet presentation.

The possibilities for monitoring the application of the Law on public procurement based on the right of free access to information are practically endless. Naturally, for such monitoring to yield results, the “right questions” need to be asked, while delving deep in what was until recently considered an exclusive and confidential area of public service activities along with the ability to adequately process obtained information and present it in the best possible way. Many civil society organizations can give their contribution in following the implementation of public procurement regulations, each in its own sector or a specific area. The role of specialized organizations, such as the Transparency Serbia, is therefore dual – aside from following the implementation of regulations in the public service, they also help (educate) other subjects within the civil society and the private sector to independently monitor various activities, perform information checks, point to irregularities and demand their rectification.

Detecting system vulnerabilities

The upshot of following the law application is the detection of bottlenecks that prevent smooth system operation and the achievement of desired results and goals. Some weaknesses in the legal and institutional framework are already visible. As can be seen from international experience presented in the “Global Corruption Report for 2005”, corruption in public procurement is a monster “with a hundred faces”. Previous following of public procurement in Serbia reveals that the existing legal and institutional framework is able to provide only partial relief in efforts to protect public procurement from corruption.

In early stages that precede the process of bidder selection during procurement planning when resources are allocated for the undertaking, potential bidders could use corruption to induce the “need” of purchasers for certain products, services, and works. Therefore, the suitability of planned procurement ought to be the subject of internal controls and auditing institutions in order to make the best use of limited budgetary resources.

After the suitability of a given public procurement has been established, the purchaser should strive to outline conditions that reflect his true needs, as opposed to what a targeted prospective bidder would hope to sell. Openly discriminatory conditions can be eliminated through the process for the protection of bidders’ rights, but doing away with prejudicial terms and conditions that appear legitimate is much more complex. In such cases, substantial yet unchecked power rests with companies and consultants that are preparing the tender documentation. The existing ban prohibiting companies that have taken part in the creation of the tender documentation from preparing offers for certain bidders is neither sufficient nor efficient when it comes to preventing abuse in determining the tender criteria. For that reason a three-layer protection system must be implemented: public service offices engaged in purchasing need to establish a planning mechanism based on their real operating needs, which should yield sound decisions that are accessible to the public on why goods, services and works of a certain quality or with specific features are needed; ethical rules along with anti-corruption and disciplinary mechanisms need to be formulated and implemented within certain professions and in companies that appear as consultants; inspection teams and investigative bodies should have adequate resources at their disposal in order to perform timely checks in cases where there is suspicion of a connection between the parties that took part in a public procurement process both on the side of the purchaser and the bidder.

The abuse of legal options in efforts to complete procurement without a tender (for instance, due to urgent needs or because there is only one supplier) has still not been prevented in an efficient manner. The Public Procurement Office, which approves such procedures, does not have a mechanism whereby it would be able to establish the veracity of claims that are used as basis for issuing favorable decisions. Even though the purchaser accepts full responsibility for making false claims, there is a strong public interest to expose as many frauds of this kind as possible through controls by various inspection offices within the public administration.

Fighting against secret agreements between the bidders that create the illusion of genuine competition, thus causing damage to the purchasers, requires the introduction

of tougher penalties for companies that engage in such collusion along with improved fraud-detection mechanism. In cases of this kind inside information is extremely valuable as investigators are unable to uncover fraud without them, hence individuals who report such schemes must be granted complete legal and every other protection necessary. Moreover, companies that are caught red-handed must also face long-term consequences with the ban on participating at public procurement tenders being one of the most efficient deterrents.

Regulations that govern the matter in the existing Law on public procurement should be constantly improved by eliminating noted procedural deficiencies and compelling the Public Procurement Office, as a state institution entrusted with following the implementation of the law and an organization that is in contact with both the purchasers and the bidders, to periodically draft the concept of enhancing the current legislation in accordance with public procurement regulation modifications in EU countries.

The commission that makes final decisions in the process of protecting bidders' rights is still a part of the executive branch of the government. In such a situation, even when commission members are not under pressure (which has happened) to issue a specific ruling, render a decision within a particular timeframe or cast the case aside, it can be inferred that the sheer lack of separation and a mechanism that would protect the commission from undue influence, represents an obstacle for its full professionalism and impartiality. The manner in which commission members are elected and their status must be such as to ensure the highest possible level of expertise, political impartiality, and independence from various interests and lobby groups, both from those that implement public procurement and those who object to the decisions made by the purchasers, bearing in mind the regulations on the prevention of the conflict of interest. As well, only timely decisions from the commission can hope to have a desired effect. Therefore, adequate conditions should be created based on the current experience to enable the commission to handle the volume and the complexity of motions filed for the protection of rights.

The control of contract execution in public procurement is absolutely inadequate. The majority of the affairs involving public procurement over the last few years pertained to illegal changes of the procurement value after the contract has been signed, which violated procedures prescribed by law in a roundabout fashion, and the delivery of goods and services that failed to meet agreed quality standards. In a country where the efficiency of legal protection is fairly low, these shortcomings within the legal framework represent an open invitation for corruptive behavior and fraud in public procurement. The Law on public procurement does not itself deal with issues governing the implementation of procurement contracts. The control of contract execution ought to be within the purview of purchasers' supervisory bodies, including quality assurance by expert staff along with all forms of internal financial controls (in terms of accepting various obligations, payment clearances, etc). In addition to internal controls there should be a functional external control regarding the use of budgetary resources.

Serbia is one of the few remaining European countries that does not have a supreme auditing institution. Such an institution would be of great assistance in conducting

controls of the legality of the process for concluding public procurement contracts and monitoring of contract execution. The initiatives aimed at establishing the supreme auditing institution should yield a draft bill on the matter soon (by the parliamentary finance committee). In all of its analysis and strategic documents published from 2001 to date, the Transparency Serbia considered founding of this institution as one of the priority tasks in efforts to successfully fight against corruption in Serbia. At any rate, another two years are certain to pass at least before this institution is up and running. This is why a lot more needs to be done in the meantime to strengthen the capacity, authority and independence of public services that should control the use of budgetary resources for public procurement purposes under existing regulations. According to the budget system law, offices for internal control that are part of every larger budgetary user ought to perform this function. These services, however, mostly do not exist even on paper. On the other hand, budgetary inspection and auditing office, which operates under the wing of the finance ministry, lacks many legal remedies that could make its work substantially more efficient. Additionally, the scarcity of human resources along with the absence of a viable network of local inspection and auditing offices further hinder efforts to complete the necessary controls and review business activities of all purchasers in the sense of the Law on public procurement in a timely fashion.

The implementation of good international experience as a corrective mechanism

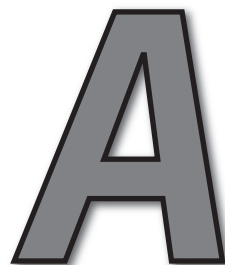
Examples of good experience from other countries, available for reading in this publication as well, could be successfully applied in Serbia. There is, however, no doubt that for such course of action to succeed the citizens (as voters and taxpayers) need to realize the importance of creating an efficient control system and ensuring accountability of persons entrusted with making decisions in their name. Furthermore, raising awareness about the need to follow all phases of the budgetary process becomes a priority, not only for curbing corruption, but also for creating a healthy democratic society. In addition to having a responsible public sector, the citizens should rightfully demand that the private sector adhere to the same standard and act responsibly in its environment, too. Various aspects of socially responsible behavior have already become the norm in everyday life in the developed world. Nonetheless, the public can hope to win responsible behavior from the private sector only if it clearly demands it. Accountability and ethical behavior in the private sector assume refraining from the use of illegal means, such as giving or taking bribes, rigging the bidding process and taking part in tweaking conditions on public procurement tenders for the benefit of certain suppliers, against the public interest.

A rising interest among the public for following the flow of budgetary resources can result in sufficient pressure on the governments and companies alike, forcing them to accept independent observers in activities that take place before and after a public procurement contract is signed, and oblige themselves to sign agreements such as the one promoted by the Transparency International called the “Integrity Pact” – an agreement on fair procurement. The implementation of such agreements in Serbia would certainly

provide additional budget savings, while helping to foster a new climate in terms of building sound relationships between the government, private sector and the citizens – a mutual trust that is necessary both for strengthening democracy and the implementation of future reforms.

The implementation of measures within professional organizations, which have already achieved commendable results internationally, could also prove to be effective in Serbia. Members of these organizations are capable of assuming an important role in public procurement, especially in preparing the tender documentation. In similar vein, documents such as the Representative Model Agreement from the International Federation of Consulting Engineers (FIDIC) and internal ethical codes of professional organizations can serve as corrective mechanisms, provided that adequate disciplinary sanctions are imposed for regulation breaches.

Finally, international financial organizations that are active in Serbia ought to be open for cooperation with civil society associations in these endeavors. Many of those organizations have already developed their own standards and procedures for fair public procurement, which are financed from their donations or loans, but some of them can also be applied to public procurement contracts that are funded from the budget. The cooperation between non-governmental organizations and international financial organizations during the third phase of public procurement system development in Serbia is becoming all the more important. Their collaboration should result in improved capacity to better monitor public procurement in the future, thus paving the way for sustainable development after Serbia successfully completes its transition and creates the necessary legal and institutional framework.



GLOBAL CORRUPTION REPORT 2005

Foreword

Francis Fukuyama¹

One of the major changes in the global intellectual climate over the past decade has been a reawakening of interest in, and appreciation for, the role of the state in development. Since the Reagan–Thatcher revolution of the late 1970s to early 1980s, much of the emphasis in public policy has been on reducing the scope of the state and getting government out of the way of private markets. This emphasis was appropriate for countries like China and India that had reasonably competent but overreaching governments. But for much of the developing world, weak state capacity is responsible for persistent poverty, disease, drug and human trafficking, terrorism, and a host of other social dysfunctions.

Free markets are not self-sustaining: they presume the existence of governments that are capable of enforcing the rule of law, adjudicating disputes, and establishing property rights as the basis of long-term investment and growth. Even the act of reducing the scope of a state through privatisation necessitates government agencies that can value and auction state-owned enterprises in a transparent and non-corrupt fashion. Weak governance has been a problem throughout the developing world. But in some cases, governance has been missing altogether as a result of war or internal conflict, producing collapsed or failed states that abuse or neglect their own citizens and become acute problems for their neighbours and the rest of the world. While international politics of the twentieth century was characterised by clashes between large, powerful and

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well-organised states, the twenty-first century has seen instability springing from states that are too weak.

Recognition that ‘institutions matter’ and that good governance is a key part of any development strategy has become widely accepted within the development policy community in recent years. In countries with weak states and poor governance, cutting back the state through privatisation and deregulation is not enough to trigger growth. Market-friendly reforms need to be accompanied by positive acts of institutional reform and state-building.

And yet, the consensus over the importance of institutions and good governance belies several critical weaknesses with regard to implementation. The so-called first-generation reforms – getting macroeconomic policy under control, reducing tariffs, privatisation, deregulation, and so on – were relatively straightforward, because they concerned policies that were at least nominally under the control of governments. But second-generation reforms that focus on strengthening those very state institutions are much more difficult to implement. While a handful of technocrats might be able to ‘fix’ monetary policy or a dysfunctional central banking system, there is no comparable group of specialists who can reform a legal system or clean up a corrupt police force. Such institutions, which are critical for the functioning of a market economy, are large, complex, and deeply steeped in the local traditions and culture of the societies in which they operate. They are, moreover, at the core of the country’s political system and can potentially threaten the interests of wealthy and powerful elites.

It is in this context that the work of Transparency International has been of critical importance. Transparency International was one of the first organisations to recognize the importance of governance to development, and to develop long-term strategies for combating it. Too often in the past, development agencies and multilateral lenders were willing to overlook corruption, believing either that it did not constitute a serious obstacle to development, or else that outsiders had no choice but to work through corrupt local officials. Transparency International broke the mould by putting the need for open and competent government at centre stage.

The *Global Corruption Report 2005* focuses on the construction sector. We are all painfully aware that corruption in construction contracting is not a problem unique to poor countries; industrialised nations from Japan to the United States have faced continuing problems in this sector. Construction projects are big and complex and, most important, they involve lots of money. This report, like those of previous years, presents strategies to deal with the problems it analyses. Iraq in particular serves as an example of the dilemmas faced by nation-builders when contracting in post-conflict situations. There has been great political pressure to write contracts quickly, which sometimes provides the opportunity to waive the normal acquisition rules. How to balance competing requirements for honesty and efficacy is an ongoing dilemma with, as this report indicates, no easy solutions.

Improving governance by fighting corruption has institutional, normative, and political dimensions. Countries need good institutions that minimise the incentives public officials face to take bribes. But even the most optimally designed institutions will not

prevent corruption if a society's norms say it is acceptable to take bribes, or if the country's elites regard politics as an arena for self-enrichment. Finally, it is not possible to reform institutions or change norms unless there is political will to do so. While outside donors and lenders can try to influence behaviour through conditionality and advice, it is ultimately up to local elites to come to grips with the problem of corruption and make the painful choices needed to do something about it.

Transparency International contributes enormously in all of these ways: institutional, normative and political. It has laid the groundwork for concrete reform strategies on a country-by-country basis. It has also helped to change the moral and political climate both in developing and developed countries with regard to the acceptability of corruption. This year's *Global Corruption Report* extends Transparency International's record of service to the international community in laying the groundwork for better governance, and hence long-term development.

Introduction

Peter Eigen, Chairman, Transparency International

Corruption doesn't just line the pockets of political and business elites; it leaves ordinary people without essential services, such as life-saving medicines, and deprives them of access to sanitation and housing. In short, corruption costs lives.

Nowhere is corruption more ingrained than in the construction sector, the focus of Transparency International's *Global Corruption Report 2005*. From the Lesotho Highlands Water Project (page 31) to post-conflict reconstruction in Iraq (page 82), transparency in public contracting is arguably the single most important factor in determining the success of donor support in sustainable development. Corrupt contracting processes leave developing countries saddled with sub-standard infrastructure and excessive debt.

Building a world free of bribes

However ingrained corruption seems, it can be beaten. Transparency International (TI) has pioneered the no-bribes Integrity Pact, which includes sanctions such as blacklisting if a bidder for a public contract breaches the no-bribes agreement (page 59). Now used in more than 20 countries around the world, in 2003–04 TI's campaigning bore fruit on a global level. The Integrity Pact is increasingly being used by multilateral development banks, a major breakthrough that will bring tremendous benefits to ordinary people in the developing world.

In September 2004 the World Bank announced a decision to require companies bidding on large Bank-financed projects to certify that they 'have taken steps to ensure that no person acting for [them] or on [their] behalf will engage in bribery'. This breakthrough is evidence of the increasing impact of the anti-corruption movement in shaping the global agenda.

Another initiative of TI (together with Social Accountability International and a group of international companies), the Business Principles for Countering Bribery, offers companies practical guidance on how to prevent corruption throughout their operations. In January 2004 at the World Economic Forum in Davos, 19 leading international companies took a major step towards building a corruption-free construction sector when they signed up to Business Principles customised for the engineering and construction industries (see page 49).

The costs of corruption

These and other initiatives are essential if we are to build a world free of bribes. More than US \$4 trillion is spent on government procurement annually worldwide. From the construction of dams and schools to the provision of waste disposal services, public works and construction are singled out by one survey after another as the sector most prone to corruption – in both the developing and the developed world. If we do not stop the corruption, the cost will continue to be devastating.

Most horrifically, the cost will be lives lost. In the past 15 years alone, earthquakes have killed more than 150,000 people. As James Lewis writes, '[e]arthquakes don't kill people; collapsing buildings do' (page 23). Examples from Turkey and Italy demonstrate that buildings often collapse because building and planning regulations are ignored – and regulations are often ignored because bribes have been paid to bypass them.

In economic terms, research gathered by Paul Collier and Anke Hoeffler (page 12) demonstrates how corruption raises the cost and lowers the quality of infrastructure. Corruption also slows down development, reducing long-term growth rates. In short, corruption has the potential to devastate emerging economies.

Corruption in the construction sector not only plunders economies; it shapes them. Corrupt government officials steer social and economic development towards large capital-intensive infrastructure projects that provide fertile ground for corruption, and in doing so neglect health and education programmes. The opportunity costs are tremendous, and they hit the poor hardest. Were it not for corruption in construction, vastly more money could be spent on health and education and more developing countries would have a sustainable future supported by a functioning market economy and the rule of law.

Corruption also steers public spending towards environmentally destructive projects. Peter Bosshard (page 19) points to 'monuments of corruption' the world over – huge construction projects that went ahead only because bribes were paid and environmental standards were not applied. The Yacyretá dam in Argentina, the Bataan nuclear power plant in the Philippines and the Bujagali dam in Uganda have all been subject to allegations of the improper diversion of money. Too frequently, corruption results in redundant infrastructure projects with potentially disastrous environmental consequences.

The bricks and mortar of corruption

The list of construction projects plagued by corruption is a long one. The *Global Corruption Report 2005* presents case studies from Lesotho (page 31) and Germany (page 51), while the country reports on China, Costa Rica, the Czech Republic, Norway and

others all cite allegations of corruption in construction during 2003–04.

Neill Stansbury describes (page 36) how the characteristics of the construction sector slant it towards corruption: the fierce competition for ‘make or break’ contracts; the numerous levels of official approvals and permits; the uniqueness of many projects; the opportunities for delays and overruns; and the simple fact that the quality of much work is rapidly concealed as it is covered over by concrete, plaster and cladding.

Too often, international investors and financial institutions are also culpable in supporting corruption. An over-readiness to lend against a background of weak oversight and accounting safeguards has led the World Bank and regional development banks to invest heavily in projects that have been subject to allegations of corruption. Export credit agencies (ECAs) – semi-governmental agencies that provide guarantees and insurance for domestic companies seeking business abroad – have also been heavily criticised for lack of transparency and their willingness to continue working with construction companies known to be corrupt. As Susan Hawley argues (page 55), multilateral development banks and ECAs have an impact and responsibility far beyond the sums of money they themselves invest, not least because the guarantees they issue help mobilise private sector investment.

Rebuilding after war

Corruption in public contracting seems particularly intractable in post-conflict situations, marred by weak government structures, thriving black markets, a legacy of patronage, the sudden influx of donor funds, and the need to ‘buy’ the shortterm support of former combatants. From Iraq to Afghanistan, from Cambodia to the Democratic Republic of Congo, time and again the lessons of the past are ignored and corruption is allowed to thrive in the wake of conflict.

Recognising how tragically frequent conflicts are around the world, the *Global Corruption Report 2005* contains a special feature on corruption in post-conflict reconstruction. Philippe Le Billon examines the nature of corruption in post-conflict situations (page 73), and points to the particular damage it can do, undermining both peace-building efforts and the rule of law, storing up serious long-term problems.

The need for anti-corruption measures is particularly acute in the first years after conflict. As Reinoud Leenders and Justin Alexander argue in their case study of Iraq (page 82), strong and immediate measures to curb corruption will be essential when the real spending on reconstruction starts. Without a systematic commitment to transparency in the reconstruction process, Iraq is at risk of becoming the biggest corruption scandal in history. The consequences for ordinary people will be immense and long-lasting.

Concrete reforms are needed

To combat corruption within the construction sector, all actors need to be involved. Company shareholders, professional trade bodies and civil society organisations all have a part to play in exposing and combating malpractice (see recommendations on pages 65–70).

First and foremost, however, it is governments that bear the greatest responsibility for ensuring the honest and transparent management of public funds. The *Global Corruption Report 2005* launches TI's Minimum Standards for Public Contracting (see box), a baseline for all governments, both for public works and far beyond. As with all anti-corruption measures, getting the rules right is only a first step. As many of the *Global Corruption Report's* country reports show, enforcement rarely matches up to the standards to which governments pay lip-service.

Private sector anti-corruption initiatives have been implemented under the auspices of the World Economic Forum (page 49) and by the International Federation of Consulting Engineers (page 40) in attempts to bolster standards. While laudable, such initiatives need to be implemented wholeheartedly and taken up right across the sector. Otherwise, they will remain merely good intentions and will not succeed in creating a level playing field.

International financial institutions have also taken steps to implement reforms. The World Bank, for example, has started to blacklist companies known to be corrupt (page 59). While this is significant progress, it is essential to ensure the adoption of debarment systems by all the regional development banks as well. ECAs are also in urgent need of reform. While they increasingly acknowledge what good practice requires of them, concrete actions are still required. All international financial institutions have a special responsibility to carry out due diligence on the projects and companies for which they provide backing.

Corruption cannot be overcome without political will and courageous leadership. Politicians and government officials are in a position to show that leadership, but civil society must also be ready to monitor their actions, to check that they keep their promises and hold them to account.

Our vigilance will do more than improve government finances and the quality of investments in construction and infrastructure projects. It will ensure public money is used for the public good, and it will save lives.

The *Global Corruption Report 2005* opens with a tribute to one individual, Satyendra Dubey, who was murdered after he courageously spoke out against corruption in the construction of a massive highway project in India. At the Transparency International Integrity Awards 2004, a special posthumous tribute was paid to Dubey in recognition of his contribution to the fight to rid the world of corruption.

Transparency International's Minimum Standards for Public Contracting

Transparency International's Minimum Standards for Public Contracting provide a framework for preventing and reducing corruption based on clear rules, transparency and effective control and auditing procedures throughout the contracting process.

The standards focus on the public sector and cover the entire project cycle, including needs assessment, design, preparation and budgeting activities prior to the contracting process, the contracting process itself and contract implementation. The standards extend to all types of government contracts, including:

- *procurement of goods and services*
- *supply, construction and service contracts (including engineering, financial, economic, legal and other consultancies)*
- *privatisations, concessions and licensing*
- *subcontracting processes and the involvement of agents and joint-venture partners.*

Public procurement authorities should:

1. Implement a code of conduct that commits the contracting authority and its employees to a strict anti-corruption policy. The policy should take into account possible conflicts of interest, provide mechanisms for reporting corruption and protecting whistleblowers.
2. Allow a company to tender only if it has implemented a code of conduct that commits the company and its employees to a strict anti-corruption policy.
3. Maintain a blacklist of companies for which there is sufficient evidence of their involvement in corrupt activities; alternatively, adopt a blacklist prepared by an appropriate international institution. Debar blacklisted companies from tendering for the authority's projects for a specified period of time.
4. Ensure that all contracts between the authority and its contractors, suppliers and service providers require the parties to comply with strict anti-corruption policies. This may best be achieved by requiring the use of a project integrity pact during both tender and project execution, committing the authority and bidding companies to refrain from bribery.
5. Ensure that public contracts above a low threshold are subject to open competitive bidding. Exceptions must be limited and clear justification given.

6. Provide all bidders, and preferably also the general public, with easy access to information about:
 - activities carried out prior to initiating the contracting process
 - tender opportunities
 - selection criteria
 - the evaluation process
 - the award decision and its justification
 - the terms and conditions of the contract and any amendments
 - the implementation of the contract
 - the role of intermediaries and agents
 - dispute-settlement mechanisms and procedures.

Confidentiality should be limited to legally protected information. Equivalent information on direct contracting or limited bidding processes should also be made available to the public.

7. Ensure that no bidder is given access to privileged information at any stage of the contracting process, especially information relating to the selection process.
8. Allow bidders sufficient time for bid preparation and for pre-qualification requirements when these apply. Allow a reasonable amount of time between publication of the contract award decision and the signing of the contract, in order to give an aggrieved competitor the opportunity to challenge the award decision.
9. Ensure that contract 'change' orders that alter the price or description of work beyond a cumulative threshold (for example, 15 per cent of contract value) are monitored at a high level, preferably by the decision-making body that awarded the contract.
10. Ensure that internal and external control and auditing bodies are independent and functioning effectively, and that their reports are accessible to the public. Any unreasonable delays in project execution should trigger additional control activities.
11. Separate key functions to ensure that responsibility for demand assessment, preparation, selection, contracting, supervision and control of a project is assigned to separate bodies.
12. Apply standard office safeguards, such as the use of committees at decision-making points and rotation of staff in sensitive positions. Staff responsible for procurement processes should be well trained and adequately remunerated.
13. Promote the participation of civil society organisations as independent monitors of both the tender and execution of projects.

Exposing the foundations of corruption in construction

Neill Stansbury¹

Surveys reveal corruption to be higher in construction than in any other sector of the economy.² The scale of corruption in construction is magnified by the size and scope of the sector, which ranges from transport infrastructure and power stations at the larger end to domestic housing at the smaller. It is a sector that includes projects initiated by both governments (often termed ‘public works’) and the private sector. Estimates of the total size of the global construction market are around US \$3,200 billion per year. Its share of the economy varies from 5–7 per cent of GDP in developed and advanced developing countries, and around 2–3 per cent of GDP in lower-income developing countries.³

There is significant variation across the industry as to the nature and extent of corruption. Some sectors and territories are relatively free from corruption, and a significant number of organisations and individuals try to avoid corruption at all costs. The majority of contractors who do engage in corrupt practices tend to do so not because they want to, but because they feel they are forced to by the way the industry and the political environment operate.

1. Neill Stansbury is project director for construction & engineering at TI(UK). He is a lawyer specialising in the construction and engineering industry.

2. Transparency International’s 2002 Bribe Payers Index (summarised in the *Global Corruption Report 2003*) reported that construction/public works are perceived to have the highest level of bribery of any sector, higher than both the arms industry and the oil and gas sector. Control Risks Group carried out a survey of business leaders in six developed countries (Britain, Germany, Hong Kong, Netherlands, Singapore and the United States), which also found construction/public works to be the most corrupt sector of all. See *Facing Up to Corruption* (London: Control Risks, 2002), summarised in the *Global Corruption Report 2004*.

3. UNCTAD, Regulation and Liberalization in the Construction Services Sector and its Contribution to the Development of Developing Countries (UNCTAD, 2000), available at www.unctad.org/en/docs/c1em12d2.en.pdf.

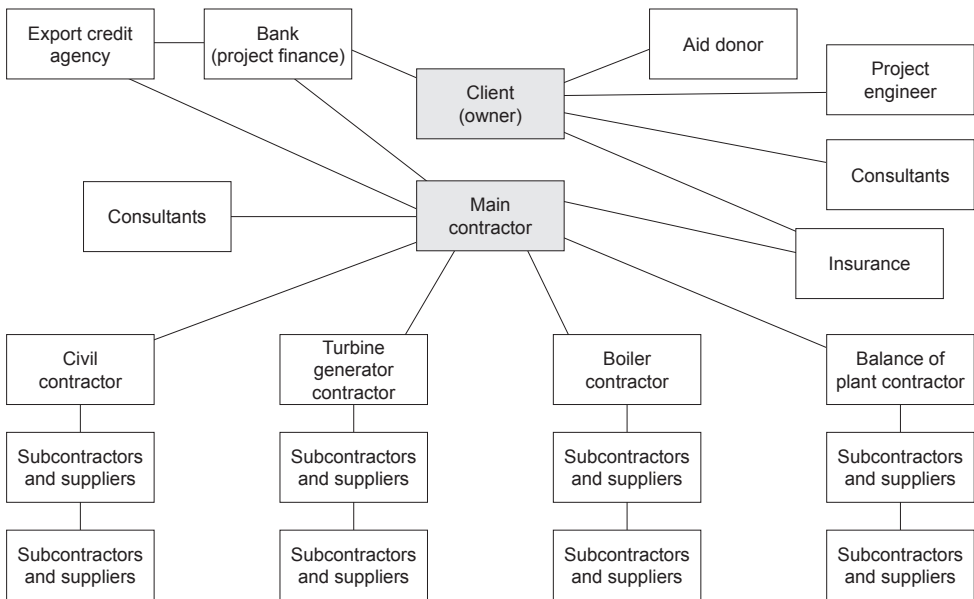
Why is construction so prone to corruption?

Construction projects usually involve a large number of participants in a complex contractual structure. Figure 2.1 illustrates one possible (simplified) contractual structure for building a power station. Each line represents a contract between two actors (companies, governments, banks and so on).

In the construction of a power station, the ‘client’ (or owner) will normally be a government or a public corporation. At the project planning stage, the client contracts consultants and engineers (see top right of the figure) to carry out feasibility studies, environmental impact assessments and other planning exercises. The client will also raise project funds by negotiating agreements with commercial banks, development banks and international financial institutions (see top left of the figure). The client then awards the main construction contract to a single company (the ‘main contractor’) after carrying out a public tender according to the relevant regulations on public contracting.

A simplified contractual structure for the construction of a power station

FIGURE 1



The ‘main contractor’ is likely to be a private sector construction or engineering company, which may then subcontract key parts of the project according to its own guidelines for awarding contracts. Subcontractors may in turn sub-subcontract parts of their work, and sub-subcontractors may purchase equipment and materials from suppliers, or award further subcontracts.

The following features of construction projects make them particularly prone to corruption:

- 1. Size of projects.** While construction projects vary in scale, infrastructure projects in particular are often huge. The costs of dams, power stations, industrial plants and highways can run into billions of dollars. It is easier to hide large bribes and inflated claims in large projects than it is in small projects.
- 2. Uniqueness of projects.** The fact that many major construction projects are oneoff makes costs difficult to compare, which in turn makes it easier to inflate costs or hide bribes.
- 3. Government involvement.** Most infrastructure projects are government-owned. Even privatised projects require government approvals for planning or agreements to pay for end-product use. The industry tends to be heavily regulated at both national and local government level. Numerous permits are often required. Where there are insufficient controls on how government officials behave, their power – combined with the structural and financial complexity of the projects – makes it relatively easy for officials to extract bribes.
- 4. The number of contractual links.** While there are numerous variations to the project structure outlined above, the contractual cascade could easily have more than 1,000 links, each depending on other contractual links in the chain. Every single link provides an opportunity for someone to pay a bribe in exchange for the award of a contract. In addition, work and services are exchanged for payment in relation to every contractual link. Every item of work and every payment provide further opportunities for bribes to be paid in return either for certifying too much work, certifying defective work, certifying extensions of time or paying more expeditiously.
- 5. The number of phases makes project oversight difficult.** Projects normally have several different phases, each involving different management teams and requiring handovers of the completed phase to the contractors undertaking the next phase. For example, a power station project may have the following phases: demand determination, choice of type (hydroelectric, coal, oil, gas), design, excavation, foundations, civil works, building works, equipment manufacture, equipment erection, commissioning and operation. Even if a single contractor undertakes all the project's phases, it will normally subcontract different elements of the task to individual subcontractors, which creates difficulties in control and oversight.
- 6. The complexity of projects.** Because of project complexity, the interrelationship between contractors and events is often uncertain. People working together on a project frequently appear not to know, or to disagree upon, the reasons why something has gone wrong, or why costs overrun. This makes it easier to blame others and to claim payment, even when such claims are unjustified. Bribes and inflated claims can easily be hidden and blamed on other factors, such as poor design or mismanagement. Complexity also generates reasons to pay bribes since decisions on cause and effect and their cost consequences can have an enormous impact.
- 7. Lack of frequency of projects.** Major projects come at irregular intervals. Win-

ning these projects may be critical to the survival or profitability of contractors, which provides an incentive to contractors to bribe.

8. **Work is concealed.** Most components in construction end up being concealed by other components. Structural steel may be concealed by concrete, brickwork by plaster, engineering components in casings, and roof structures by cladding. The industry places an enormous dependence on the individuals who certify the correctness of the work done before it is concealed; once an item is concealed, it can be very costly or difficult to check if it was completed to the required standard. This cost and difficulty creates an incentive for contractors to do defective work or use inferior materials, and to bribe the relevant official to certify that the work was done according to specification.
9. **A culture of secrecy.** There is no culture of transparency in the construction industry. Costs are kept secret even when it is public money that is being spent. Commercial confidentiality takes precedence over public interest. The routine inspection of books and records that might uncover malpractice does not normally occur.
10. **Entrenched national interests.** Local and national companies often have entrenched positions in their own market. These positions have often been cemented by bribery. International companies seeking to enter these markets may find it impossible to win work unless they pay a bribe.
11. **No single organisation governs the industry.** Construction brings together a wide range of professions, trades and specialist contractors, leading to varying standards of skill, integrity and oversight. The professions include architects, engineers, surveyors, accountants and lawyers; and the trades include machine operators, scaffolders, bricklayers, electricians and plumbers. Contractors' skills range from excavation to insulation, and from generators to cooling systems. Each profession or trade may have a different professional association, with different codes of conduct and levels of enforcement of these codes. No single organisation has overall responsibility.
12. **Lack of 'due diligence'.** The scale of funds involved in major infrastructure projects places great influence in the financing bodies that determine whether a project goes ahead, and which companies win the contracts. Commercial banks and global or regional development banks provide most of the funds, while governmentsponsored export credit agencies may underwrite risky international projects. Their frequent lack of due diligence on participants in construction projects allows corruption to continue.
13. **The cost of integrity.** It is striking how many people working in the construction sector either accept the status quo, or make no attempt to change it. Bribery and deceptive practices are so engrained that they are often accepted as the norm. Bribery is frequently a routine business cost that many companies expect to include in the contract price. The fact that so many businesses in construction routinely pay bribes or engage in deception makes it very costly for any one company to act with integrity since that company would risk losing out to its less

scrupulous competitors. As a result, many companies find themselves in a vicious circle in which they engage in corruption, often reluctantly, as a defensive measure against the corrupt practices of other companies. Fortunately, some businesses and industry associations are taking steps to change the status quo (see Box 2.1).

The mechanisms of corruption in construction⁴

Corrupt practices are found at every phase in construction projects: during planning and design, in the award of contracts, during the construction process, and during the operation and maintenance of projects after construction is finished.

Corruption in planning and design

During the planning and design stage, corruption can result in the initiation of projects that are overdesigned or overpriced. Corruption may result in the approval of projects that are unnecessary. In certain cases, projects are conceived solely as vehicles for corruption and would not have even passed the planning stage without that motivation. In others, a project might have been abandoned in the planning phase because of a critical environmental impact assessment, for example, had a bribe not been paid.

Most projects require approval, which is usually controlled by one or more public officials. Developers or contractors may pay bribes to obtain planning approval. The approval of public construction projects may also depend on the support of elected politicians at a national or local level. In such cases, opportunities exist for developers and contractors to buy support for their project by providing funds for politicians, their parties or the charitable causes that they favour.

BOX 2.1

A business perspective: Promoting integrity in consulting engineering

Jorge Diaz Padilla¹

Consulting engineering has evolved to become a major industry worldwide. The International Federation of Consulting Engineers (FIDIC)² estimates that this market represents almost US \$500 billion in annual consulting fees, of which more than half is delivered by independent, private consulting companies. Clients are increasingly requiring assurance that consulting firms operate in a corruption-free environment, especially when it comes to government procurement.

Most consulting firms are doing their best to define and implement anti-corruption policies. Such approaches tend to be piecemeal, however. What is

missing is an integrity baseline that can connect and transform isolated acts of integrity assurance into what FIDIC calls a complete Business Integrity Management System (BIMS), with formal procedures to identify potential risks, prevent and combat corruption, and implement business integrity policies for every project throughout the organisation. The 'Guidelines for Business Integrity Management in the Consulting Industry' and a FIDIC policy statement on integrity were issued in 2001, and the 'Business Integrity Management Training Manual' was published in 2002. Many companies have since developed and implemented a BIMS following the FIDIC guidelines, and some have obtained certification based on the ISO 9000 Standard.

The main steps for designing and implementing a BIMS are:

1. **Formulation of a code of conduct.** In order to ensure commitment, it is essential that the board of directors and senior management develop a code of conduct, which should be clear, simple, and easy to communicate and apply.
2. **Formulation of a business integrity policy.** The guideline requirements for an integrity policy are based mainly on the OECD Anti-Bribery Convention and FIDIC's code of ethics. The integrity policy hinges upon the fact that corruption is eliminated only by across-the-board honesty and integrity. Honesty is interpreted as freedom from fraud or deception, and integrity as the firm refusing to obtain or keep what does not fairly belong to it. The policy should be in keeping with all local rules and regulations as well as the company's code of conduct. The integrity policy must be documented, implemented, communicated internally and externally, and made publicly available.
3. **Appointment of a representative.** A senior member of the firm's management staff should be appointed as a representative to ensure that all the BIMS' requirements are met. A member of staff could also be selected to communicate between management and consultants.
4. **Identification of requirements for the BIMS.** The requirements should focus on the processes in a given firm that are vulnerable to corruption. The requirements might depend on: size and structure of the firm; the nature of its consulting services; local and national regulation and market forces; and the expectations and requirements of all the stakeholders.
5. **Analysis and evaluation of current practices.** An assessment should be made of how the firm currently deals with anti-corruption issues. The gap between current practices and the BIMS' requirements should be identified.

6. **Implementation tools for the BIMS.** A consulting firm should use the following tools to support the planning and implementation of its BIMS: a code of conduct; an integrity policy; definition of roles, responsibilities and authority; business integrity procedures for the main processes (proposal bidding and negotiation; project execution and delivery; project collection); accounting structure; enforcement measures; and a declaration of business integrity in the annual report. The firm must also establish a procedure to evaluate its sub-consultants and external advisers based on their own integrity policies, and keep records of their commitment to business integrity management.
7. **Documentation.** A BIMS must be well documented in order to provide evidence that all processes that may affect the business integrity of the services offered by the firm have been thoroughly anticipated. The extent of documentation is critical – overdocumentation may reduce staff and management interest in using the procedure. The BIMS should be documented in a general Business Integrity Manual and, if required for significant projects, in a Project Integrity Records File.
8. **Analysis of current practices.** The BIMS must establish actions to be taken in case of failure to comply with the Business Integrity Policy. Appropriate actions in cases where corrupt practices are proven range from admonition to suspension or dismissal from the firm.

Once the BIMS is operating properly, and the consulting firm is confident that the guidelines are met, the firm should initiate an evaluation process to ensure continuous compliance. This process can involve: first-party evaluation, where the management and the staff representative evaluate the BIMS; second-party evaluation based on client feedback; or third-party evaluation, by an outside body. If an external evaluation is undertaken, it may be performed as part of an ISO 9001:2000 quality certification process.

In future, a new ISO standard could be developed to certify that a company has a functioning Business Integrity System. Such a standard need not be industry-specific; FIDIC's experience with integrity management could lead to an integrity standard for the construction industry as a whole, or even for other business sectors.

1) This article is based on the work developed by the FIDIC Integrity Management Task Force, chaired by Felipe Ochoa, and the Joint Working Group on Integrity, created under the auspices of FIDIC, with participation of the World Bank, the Inter-American Development Bank and the Pan American Federation of consultants (FEPAC). Jorge Diaz Padilla is president-elect of FIDIC.

2) FIDIC, Fédération Internationale des Ingénieurs-Conseils, is the world's leading organisation representing the international consulting engineering industry. Founded in 1913, and with its headquarters in Geneva, it represents more than 30,000 firms in 70 countries.

Sometimes contractors may bribe the client's consulting engineer rather than the client's representative. A consulting engineer (which could be a major international firm) that undertakes the design for a client is in a powerful position since the engineer can design the project to favour a specific contractor's technology. In some instances, designing a contract in this way may be done in good faith in the belief that the relevant technology is best. In other cases, it may have been done in exchange for a bribe or the promise of future work.

Corruption in the award of contracts

Bribery

Bribery in relation to the award of contracts is the most visible form of corruption, particularly when contracts are for major works. This type of corruption normally involves the contractor paying a representative of the client a fee to secure the award of the contract. In some cases, the contractor bribes the consulting engineer who will advise the client that the briber's bid is the best. The payment, whether to client or consulting engineer, may be direct, though it is often made through intermediaries to obscure its identity and purpose.

- **Agents.** The most common form of intermediary is the agent. The contractor appoints an agent who has contacts with a representative of the client or with the government of the country concerned. The contractor pays the agent a percentage of the contract price on being awarded the contract. The agent passes part of the payment to the representative of the client or government in return for the contractor winning the contract. The payment is usually made in foreign currency into an offshore account. Contractors hide the bribes in formal agreements that state the scope of the agent's work. The scope of work will often be false or exaggerated, however, and the size of the payment significantly in excess of the value of any legitimate services the agent carries out.
- **Joint ventures and subsidiaries.** The level of due diligence by export credit agencies, banks and auditors is lower in some countries than others. When a contractor bids as part of an international joint venture from several countries, the joint venture may arrange for the agency agreement to be executed – and the commission paid – from the country least likely to discover the commission. Similarly, where the contractor is part of a multinational group, the commission may be paid by a subsidiary in a country where the commission is less likely to be detected. The subsidiary will then be repaid by the contractor through intercompany charges for false services or services of inflated value.
- **Subcontractors.** A contractor may also channel a bribe through a disguised sub-contract arrangement. For example, a subcontractor might agree to provide equipment and materials to a contractor in return for a certain payment, but in reality it will not provide the services, or will provide services of a vastly lower value than the price agreed. The balance of the payment can then be passed on to the relevant party as a bribe.

In many cases, the contractor would prefer not to pay a bribe at all, but is informed by the client's representative or an agent that no contract will be awarded without one. This is sometimes referred to as extortion. On other occasions, the contractor initiates the payment. A contractor may approach the representative of the client or government and request the right to negotiate a contract on a non-competitive basis in return for a bribe. The absence of a competitive tender is likely both to raise the price and expand the scope of work.

A contractor may also initiate a bribe because it knows that its competitors in the bidding process are likely to offer bribes, so that it concludes that it has to pay the bribe to 'level the playing field'. However, one innovative tool developed by Transparency International – the Integrity Pact – overturns this logic by committing all bidders to refrain from bribery (see Box 2.2).

BOX 2.2

Integrity Pact sheds light on Mexican electricity tender*Transparencia Mexicana*

Developed by Transparency International, the Integrity Pact (IP) is aimed at preventing corruption in public procurement. It consists of an agreement between a government or government department and all bidders for a public sector contract. Under an IP, both sides agree not to pay, offer, demand or accept bribes, or collude with competitors to obtain the contract, or engage in such abuses while carrying it out. Bidders are asked to disclose all commissions and similar expenses paid by them to anybody connected to the contract. Sanctions apply when violations occur, ranging from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to black-listing. Criminal, civil or disciplinary action may also be taken against employees of the government. The IP allows companies to refrain from bribing in the knowledge that their competitors are bound by the same rules. It allows governments to reduce the high cost of corruption in procurement, privatisation and licensing.

Transparencia Mexicana, TI's chapter in Mexico, had completed 15 IPs between 2001 and the time of writing, and had another 12 ongoing. The Mexican IP follows the same principles as the broader TI Integrity Pact, but has built in extra features that are intended to increase citizen participation in the contracting process. The main difference is that the Mexican IP introduces a so-called 'social witness' to oversee the process. The social witness is designated by Transparencia Mexicana and must be technically expert, independent, and enjoy a good reputation in the field. He or she must produce a final report that includes

observations and recommendations about the process, a review of qualifying criteria for bidders, an assessment of the field of bidders and an evaluation of the rationale behind decisions taken by the contracting authority.

An example of the IP in practice is the 2002 bidding for a 1,228 GWh hydroelectricity plant, known as 'El Cajón', which was billed as Mexico's most important infrastructure project of the decade. This was the first time the federal government, via the Federal Electricity Commission (CFE), had accepted independent monitoring by a civil society organisation of a bidding process in the energy sector, which in Mexico has historically been perceived by the public to be tainted by high levels of corruption. The IP lasted from August 2002 to June 2003. The first step in introducing the IP was to designate a social witness to monitor the process. The bidders were then required to submit Unilateral Integrity Declarations to Transparencia Mexicana as a condition for competing for the contract. These were signed by the highest-level officials of the bidding consortia. Declarations were also submitted by CFE officials and by all government officials involved directly in the contracting process. As part of the IP, Transparencia Mexicana met each of the bidders to ask them which parts of the process they considered might be most at risk of irregularities. Respondents said they were most worried about the fair evaluation of their proposals.

Thirty-one companies bought the guidelines for the contracting process. Of these, 21 did not submit proposals, and the remaining 10 split into three consortia that submitted proposals. These were evaluated on technical and economic grounds. The technical test was whether they complied with the qualifying criteria; the economic test was simply to determine the lowest bid. On the basis of the evaluation, the contract was offered to the consortium comprising Constructora Internacional de Infraestructura, Promotora e Inversora Adisa, Ingenieros Civiles Asociados, La Peninsular Compañía Constructora and Energomachexport-Power Machine. An offer of US \$748 million was made for the contract, below the government's allocated budget for the project of US \$812 million.

The complaints process

During the bidding process Transparencia Mexicana received one complaint by email about an alleged irregularity – that the CFE had provided confidential information to one of the bidders five months before the public tendering. Transparencia Mexicana requested a meeting with the complainant but did not receive a reply. Transparencia Mexicana also asked the CFE for an explanation. The CFE replied that it had posted information on the Internet about the 'El Cajón' project months ahead of the tender, requesting feedback about the project from interested parties.

None of the bidders filed complaints about the qualification criteria, nor the legal framework for the contracting process. At the time of writing, Transparencia Mexicana was not aware of any complaints that had not been resolved.

Next steps

Transparencia Mexicana's involvement in the 'El Cajón' contracting process represents a small opening of a door to a sector that has hitherto been closed to civil society and has been damaged by allegations of corruption.

The experience also serves to demonstrate some of the limitations of the IP, however. While an IP can help safeguard the contracting process against corruption, there is no guarantee that once underway the project will not be plagued by irregularities or unethical decision taking, potentially leading to massive cost overruns. The federal government should allow for civil society to go beyond the contracting process and oversee the execution of a public works project for compliance with the contract.

The tender process may be corrupted by international pressure. For example, the government of a developed country may influence the government of a developing country to make sure that a company from the developed country is awarded a project, even if it is not the cheapest or best option. Such pressure can take many forms, including the offer of aid, arms deals or agreements to support a government's application to join an international organisation. Great lengths are taken to conceal this pressure in some cases. In others, it is remarkably overt.

Although these examples relate mainly to major contract awards, the same principles apply all the way down the contractual chain. At the bottom end, a supplier may make a payment of US \$100 to the procurement manager of a company in exchange for a minor supply contract. At the top end, the main contractor may pay US \$50 million to the representative of a government in return for the award of a major infrastructure project.

Deception and collusion

Deception and collusion in the award of contracts takes many forms, typically involving a cartel:

- A group of contractors ostensibly in competition may secretly collude, agreeing to share future projects between them so as to keep prices high. They choose the winning bidder for a specific project and note the price to be submitted by the bidder they have agreed to pre-select. They all tender, but at prices higher than their favoured contractor, who the client then chooses as the cheapest option. The client is deceived into believing there was genuine competition in the bidding process.

- A group of contractors bidding for a project may secretly agree that each will include a pre-agreed sum in their tender that reflects the estimated aggregate bidding costs of all the tenderers. They do not pre-select the winning bidder, but tender in open competition. Whichever bidder is awarded the project then divides the pre-agreed sum between all the other tenderers as a 'loser's fee'.
- A group of suppliers of materials may collude to fix the minimum price of the materials they supply. Even when there is competitive tendering, prices will be kept higher than would be the case with genuine competition. This form of collusion is often accompanied by bribery. For example, a bribe may be paid to a client's representative in order to obtain internal information on the expected budget, or to limit the number of bidders allowed.

Corruption during construction

Bribery

Bribery does not stop on the award of the contract. There are many actions after the award of a contract that can have a significant financial impact on the participants and which are therefore prone to bribery:

1. **Agreeing 'variations' to the contract.** It is rare for a contract to be completed in precisely the same form as originally agreed. Changes to the design or construction method may be required due to error in the original design, the intervening circumstances (such as unknown ground conditions), or the client's decision to change the requirements after the project is started. Changes to design or method are normally reflected in 'variations' (or 'change orders') to the contract. Variations normally have cost consequences, as parts of the agreed work may be wasted, new items may have to be ordered, or additional labour and materials may be required. Variations therefore create opportunities for bribery between the contractor and the representative of the client, or the architect or engineer responsible for authorising the variation and approving its cost consequences. Major infrastructure projects can contain thousands of variations, ranging in cost from a few hundred to several million dollars. The cost effect is not only felt at the level of the main contract. Because of the complexity of the contractual structure in large construction projects, the effects and costs of variations need to be agreed between all affected participants, offering multiple opportunities for bribery.
2. **Concealing deferred bribes.** Variations provide a mechanism to conceal deferred bribes. A contractor may win a contract tender as the lowest-priced bidder without including a bribe in the contract price, but with a clandestine arrangement with the client's representative that a large variation including a bribe will be agreed at a later stage. Deferring a bribe until after the appointment of the contractor can be an effective means of concealment since there is no competitive tender for variations, and post-contract variations attract much less publicity than competitive tenders. The price of any variation (and of the bribe concealed within it) can therefore be extremely significant.

3. **Project delays.** It is very common for a project to finish later than scheduled whether due to adverse weather, variations, subcontractor failure or defective materials. The cost effect of delay can be significant. If the delay is the contractor's fault, the client may be entitled to claim liquidated damages from the contractor. If the delay is the client's fault, the contractor may be entitled to claim additional costs for delay and disruption from the client. As a result, the person responsible for agreeing the time and cost effect of delays is vulnerable to bribery. These ramifications may be felt all the way down the contractual structure, offering multiple opportunities for bribery.
4. **Concealing standard work.** The quality of construction is central to a project. Since a large proportion of the work and materials is concealed as the project progresses, it can be difficult or costly to verify bad workmanship or inferior materials after the work has been covered. Therefore, checkers need to certify work as it progresses. These checkers are vulnerable to bribes to certify that defective or non-existent work is acceptable. The defects may not be discovered until many years later.

While some of the above examples depict the contractor bribing the architect or the client's representative, the converse is equally possible. The client may bribe the architect to certify falsely that the contractor delayed the project, with the result that the client is entitled to deduct liquidated damages from payments due to the contractor. The client may bribe the project engineer to certify falsely that the contractor's works are defective, entitling the client to withhold the contractor's retention payment.

The dispute resolution process is also not immune. Witnesses can be paid to give false evidence; experts can be paid for false 'independent' reports; and judges or arbitrators can be bribed to hand down favourable judgments. Construction disputes can be very complex: it may be difficult to prove that the opinions of witnesses, experts and judges have been unfairly influenced. Bribes to witnesses or experts may be cash, but they could equally involve the promise of future or continued employment.

Deception

Deceptive practices during project execution do not receive the same level of attention as bribes paid to win contracts, but deception is extremely common during this phase and may exceed the costs of bribery in terms of financial wastage. Deception involves actions that many people in construction regard not as corrupt, but as 'part of the game'. Deception can have an enormous impact on the overall contract price. It can occur at every contractual link and the cost of overcharges at the bottom end of the contractual ladder may be passed all the way up with a charge added at every rung, magnifying the cost of the initial deception. This is known as claims fraud or claims inflation.

- As noted earlier, variations can be made to the scope of contracts during execution and projects can be delayed. The cost consequences of variations and delays are sometimes resolved to the advantage of one contractual party through bribery,

but a more common response is deceptive conduct. If the client issues a contractor with a variation order to change the scope of work, the contractor may take the opportunity to exaggerate the cost of the variation or the delay it causes. The contractor may also blame a delay that is the contractor's own fault on the client or the architect in a bid to avoid liquidated damages for delay, and to entitle the contractor to claim additional costs from the client.

- The client may also create artificial claims against the contractor. For example, a client may falsely allege that the contractor has delayed the project, or used inferior work or materials, in order to lay the foundations for an exaggerated or false claim to set off against sums due to the contractor. In doing so, the client knows the contractor can only receive payment by going to court or arbitration, which is expensive and time-consuming. The client may hope that the contractor will either give up the claim, or settle for a lesser payment than the amount actually due.
- An architect appointed by the client to work in the dual and conflicting roles of designer and certifier may avoid issuing a certificate entitling the contractor to additional cost or an extension of time, if the cause of that cost or time was a design error by the architect. This is deceptive conduct by the architect, who should exercise the function of certifier impartially.
- Deceptive practices by subcontractors and suppliers can also inflate project costs. A scaffolding firm may exaggerate the amount of scaffolding on site, or the number of men used to put it in place. An earth-works subcontractor may falsify the amount of earth removed.
- Lawyers and other professional advisers, whose livelihood depends on claims, can materially exacerbate the situation. They may allocate too many staff to work on a claim, charge for too many hours of work or give the client over-optimistic advice as to the likelihood of a claim's success.
- A contractor or client may enhance the deception by appointing an 'independent' expert to give testimony to support their case. An independent expert is meant to be impartial so as to help the dispute resolution tribunal come to a decision. If the expert gives an opinion which is not independent but slanted to one party's case, it may have a significant impact on the outcome of the hearing. Similarly, employees may give evidence that they know to be false in order to help their employer win a case.
- In many claims, a significant amount of false extra cost is added as a 'negotiation margin'. The claimant's logic in including this margin is that the opponent will automatically seek to reduce the claim and so a sufficient margin must be added to enable negotiations to arrive at the 'correct' figure.

Corruption during operation and maintenance

Once the project is completed, it will need to be operated and maintained. The operation of the project may require the supply of consumables such as fuel and raw materials. Roads need to be repaired and industrial plants need routine maintenance, repair and refurbishment.

As many opportunities for bribery and deception exist in this phase as during the contract award and construction phases. Bribes can be paid to win operation and maintenance contracts, and deceptive practices can lead to inflated costs. In many projects, the cost of operation and maintenance will exceed the actual capital cost of constructing the project. As a result, the opportunities for bribery may be greater.

Sometimes the same contractors that build the plant will also operate and maintain it, and so the bribe paid to win the main contract may also cover operation and maintenance. In some public/private projects, where a private consortium builds, owns and operates a project and then supplies the government or local utility with the end product, substantial opportunities exist for bribery in relation to agreeing the price that will be paid for the end product.

In high-technology projects, the contractor that built the project may be the only company capable of maintaining it. This gives it a monopoly of supply during the maintenance period, making cost comparisons difficult, and increasing the opportunities for concealing bribes and inflating claims.

In addition, high operating and maintenance costs may be a direct result of corruption during the contract award or construction phase. Corruption in the bidding process may be linked to the over-specification of a project, which may increase the costs of operation and maintenance. Corruption in the construction process may lower the standard of construction, increasing the subsequent need for expensive repair and maintenance.

Countering bribery

The construction sector is complex, diverse and fragmented, all of which contribute to a lack of effective control and the absence of uniform integrity standards. When combined with the complexity of the contractual structure, enormous opportunities are provided for corruption to flourish. The lack of transparency surrounding projects and the contentious environment both tend toward bribery and deception. The fact that bribery and deception are such common parts of industry practice leads many participants to accept them as the status quo, rather than attempt to change the way business is done. However, there are things that can be done – this report's recommendations (see page 65) set out concrete proposals for reform – and positive steps are being taken by some businesses to counter bribery in the sector (see Box 2.3).

WEF task force adopts the Business Principles for Countering Bribery

Transparency International

At the World Economic Forum's (WEF) Annual Meeting at Davos, Switzerland, in January 2003, some leading engineering and construction companies formed the WEF Governors' Engineering and Construction Task Force in order to tackle corruption in the sector. The Task Force, working in close collaboration with Transparency International and the Basel Institute on Governance, met several times during 2003. As a result of agreements achieved at these meetings, 19 leading international companies from 15 countries with aggregate annual revenues in excess of US \$70 billion signed the 'Business Principles for Countering Bribery in the Engineering and Construction Industry' at the WEF meeting at Davos in January 2004. This document was closely modelled on the 'Business Principles for Countering Bribery' developed in 2002 by Transparency International, in conjunction with Social Accountability International and several leading multinationals. An organisation which adopts the Business Principles commits:

- to adopt a policy that bribery in any form is prohibited;
- to implement a management programme which puts into effect its anti-bribery policy.

The Business Principles also provide practical guidance in relation to the scope and implementation of the anti-bribery programme.

Engineering and construction companies have traditionally been unwilling to take a public stand against corruption. The public announcement of the adoption of the Business Principles by these 19 companies broke with this tradition, and proves that key companies in the international industry believe that something can and must be done to deal with corruption. As Alan Boeckmann, chair and CEO of Fluor Corporation and head of the WEF Governors describes, 'nothing has been more frustrating than losing a great opportunity to a competitor who is willing to pay bribes'.

The Task Force continued to meet during 2004. These meetings focused on the following key issues:

- How to increase the number of international construction companies which adopt the Business Principles. In order to have any real effect on corruption, a significant majority of companies in the sector must commit to effective anti-corruption policies. Each member of the Task Force

agreed to try to bring in additional signatories from its own territory or sector.

- How to ensure that companies that announce they have adopted the Business Principles are actually implementing a genuine anti-corruption programme. One of the ways of achieving this would be to obtain external accreditation of a company's anti-corruption programme. This idea is actively being pursued by the Task Force.
- How to ensure that companies that implement an effective anti-corruption programme are rewarded, and not penalised, for doing so. If some companies adopt an anti-corruption programme, and others do not, those that do not may continue to win work through bribery, therefore disadvantaging those that refuse to bribe. One way of ensuring that ethical companies are rewarded, is to request international financing institutions such as the World Bank, and public sector clients, to permit bids for projects only from companies that have adopted the Business Principles. In due course, once a system of external accreditation of the Business Principles has been established, only companies that have achieved the accreditation should be placed on bidders' lists. The Task Force has commenced discussions with the World Bank on this proposal and is greatly encouraged that the World Bank will in future require borrowers on large projects to certify that they will neither directly nor indirectly engage in bribery.

The next issue requiring urgent consideration by the Task Force is what inspection mechanisms should be put in place within projects to ensure that companies do not bribe. As with all voluntary codes, sceptics will question the credibility of subscribing companies' intentions. If bidders' lists require anti-bribery policies as a condition precedent, some companies may adopt them so as to reach the bidders' list, but will in practice continue to bribe. This could prejudice the companies that do adhere to the anti-bribery policy, and it is therefore in those companies' interests that proper inspection and enforcement mechanisms are put in place. TI has proposed to the Task Force the inspection and enforcement mechanisms referred to on pages 65–70.

Case study: Oversized incinerator burns up Cologne's cash

Hans Leyendecker¹

A trial in Germany, which concluded in 2004, revealed the scale of bribery in the construction of waste processing facilities. The scale of abuse is due, among other reasons, to the low number of contractors sharing the market for lucrative large-scale projects. In the country's waste-disposal sector, bribery has come to be known as 'artificial respiration'. In the case of a waste incinerator being built in Cologne, among the last projects of its kind, competition for the contract was especially fierce.

Cologne, Germany's fourth largest city, has always been known for a somewhat fluid approach to rules and ethical standards. The saying 'live and let live' is a local favourite, capturing a laissez-faire attitude known as 'Kölner Klüngel', the Cologne clique system – a misleadingly harmless name.

The dominant political parties, the Christian Democratic Union and the Social Democratic party (SPD), are part of this clique system. Their representatives often assist each other, passing along official posts and contracts. The assistance is even non-partisan: winners prop up losers, because one never knows who will be on top tomorrow.

In 2002 the city was rocked by one scandal in particular. Investigations exposed the flow of approximately DM 21.6 million (US \$13.3 million) in bribes into local pockets during the construction of a half-billion dollar waste incineration plant in a Cologne suburb. Politicians, managers and lobbyists were all involved in the affair. What emerged was an endlessly corrupt and distasteful web that ensnared the city's political caste.

1) Hans Leyendecker is one of Germany's most renowned investigative journalists. Since 1997 he has been senior political editor at the *Süddeutsche Zeitung*, a major German daily.

A web unravels

The discovery began with an anonymous tip-off. In June 2000 an informant told local tax authorities that millions of deutschmarks in kickbacks had changed hands during the construction of a waste incinerator in the 1990s. Investigators were initially sceptical. A similar investigation in 1996 had got nowhere.

This time around, federal and regional officials were investigating bribe payments in conjunction with large-scale construction projects elsewhere. So as Cologne officials rummaged through federal archives, they found interesting data on the construction sector in their backyard and across the country. It seemed the entire waste-processing landscape had been fertilised with cash.

Dishonest designs

Investigators then took a series of suspects into custody, including a former construction manager, a civil servant, industry lobbyists and an SPD official. It appeared that stacks of tainted cash had changed hands at every stage of the venture. Even years later, though, just who had initiated the scheme remained unclear.

An engineer who has designed half of all garbage incinerators in Germany, Hans Reimer, alleged that he met with a civil servant named Ulrich Eisermann in the early 1990s to talk about an engineering contract for the planned incineration facility. Eisermann allegedly remarked at the time that DM 20 million (US \$12 million) in kickbacks should be built into the price. The engineer, who maintains that bribes are paid on many large-scale projects, turned down the offer. Eisermann denies the conversation ever took place.

A clique comes together

In 1993 the manager of construction firm LCS Steinmüller met with Eisermann, the official in charge of the project. In a delicate conversation, the manager allegedly indicated how badly his company needed the contract, so badly in fact that they were ready to bribe.

Although willing, neither knew how to go about it. That was when garbage entrepreneur Hellmut Trienekens entered the game. With his extensive experience, Trienekens was able to recommend conducting bribe payments via Switzerland. He had been playing the political field for years and knew all the right channels. He had shown great interest in being involved in the waste incinerator project and he was, with his network of influence, an essential partner.

A crooked scheme

Eisermann was to ensure that LCS Steinmüller got the contract for constructing the plant. There were four bidders for the project, which had a number of phases. Eisermann had been instructed by his superiors to choose as general contractor the firm that came in as cheapest on the greatest number of project phases.

According to evidence revealed in the trial, Eisermann took the proposals home, opened the sealed envelopes with steam and carefully removed the offer letters. He

had agreed with LCS Steinmüller boss Sigfrid Michelfelder to write up the competing offers to the last detail. That same night he gave the note to Michelfelder, who revised his firm's offer. Some components were cheaper, others now more expensive. The cost of the gas flue cleaning system, for example, had increased by over DM 10 million (US \$6 million). Eisermann accepted the new offer, slipped it into the original envelope and resealed it. The scheme worked. LCS Steinmüller won the contract with Trienekens as the waste facility's co-partner.

The political parties were active from the beginning, with certain politicians lobbying vociferously for the garbage plant. They used their influence with Eisermann to strategically place major construction firms as subcontractors in the project. The parties knew that they could count on quasi-legal contributions, known as 'thank you' donations, from firms that won public contracts through the parties' lobbying efforts.

Later, at trial, the local SPD was particularly implicated. Under-secretary Norbert Rütter allegedly collected 30 such dubious donations² – some with, some without, a receipt. A party treasurer had accepted a total of DM 510,000 (US \$320,000) in major contributions originating from LCS Steinmüller and other contractors. He allegedly wove the funds into the party's account by writing receipts to party supporters for donations they never made. In a further blow, Eisermann claimed to have paid Rütter a DM 2 million (US \$1.2 million) bribe for initially advocating for the incinerator project in the city council. Rütter consistently repudiated the charge.

Once the project was underway, general contractor LCS Steinmüller regularly transferred millions of deutschmarks into the account of a shell company with a Zurich address by the name of Stenna Umwelttechnik AG (Stenna Environmental Engineering). Although an offshore entity, Stenna was responsible for monitoring the Cologne project's engineering services. A manager from LCS Steinmüller later went on record as saying that the Swiss staff of Stenna had 'randomly added official stamps and legal provisions' to documents and had 'only pretended to verify anything'.

The arrangement was a profitable one for Stenna. The shell company billed more than DM 4 million (US \$2.5 million) for taxes, banking fees and operation costs. But then, because the illicit cash flow no longer seemed safe, the connection to Stenna was dissolved in 1996 and a new shell firm was activated.

The bitter end

In May 2004 the Cologne corruption trial came to an end. Trial judges accused public prosecutors of having withheld relevant documentary evidence until it was too late for the defence to make use of it. Consequently, the accused came away with mild sentences.

Eisermann, who was alleged to have received the lion's share of bribe payments, was given a prison sentence of three years and nine months. Michelfelder, director of LCS Steinmüller, came away with a suspended sentence but had to pay a €1 million fine (US 1.2 million). There is broad speculation in the media that Trienekens collected a portion of the kickbacks – a fact he vehemently denies. He was initially sentenced to two years'

2) Süddeutsche Zeitung, 11 novembra 2003. godine.

imprisonment, but the sentence was reduced to two years' probation on the condition that he post €10 million bail, the highest amount ever imposed for a tax-related crime. Social Democrat Rütter was cleared of all charges.

The crux of the matter was not individual shortcomings. The presiding judge explained that not only 'in developing nations, but also in Germany, it is customary for people to help themselves when it comes to major construction projects'. Council members had 'allowed themselves to be drawn in on all sides'. Garbage entrepreneur Trienekens had seen to it that that an 'unending list of donations' flowed to local politicians. Damage of 'immense proportions' had been incurred.

The story illustrates that corruption always has its victims. In this case they were, once again, ordinary citizens: after all the crooked dealings, their municipal garbage collection fees had tripled, and the city had landed a facility larger than it could possibly use. The project had initially been designed to process around 400,000 tonnes per year. Behind the scenes, the influential garbage lobby manipulated figures and was able to push through a far larger facility. Trienekens even imported refuse from Naples in specially chartered trains to be incinerated in oversized plants, scattered throughout the Rhine-Ruhr region. There was money to be earned in garbage.

Recommendations

Transparency International¹



A sign stands at the construction site of Sydney's new office and retail centre, the World Square. An annual report released in March 2004 by a government-commissioned taskforce set up to prosecute unions and employers alleged widespread corruption in the construction industry, prompting federal Workplace Relations Minister Kevin Andrews to say 'the culture of unlawfulness and thuggery and intimidation still exists in the building industry'. (GREG WOOD/AFP/Getty Images)

Governments bear the greatest responsibility for ensuring the honest and transparent management of public funds. Governments must put in place rules on public contracting that meet minimum international standards. Transparency International's Minimum Standards for Public Contracting (see page 4) provide a global baseline.

Putting in place the right rules is not enough, however, given the widespread tolerance of corruption within the construction sector and given the frequent failure to

¹ Transparency International (UK) has since September 2003 been leading an anticorruption initiative in the construction sector, which involves working with the industry to eliminate corruption, and developing and promoting the anti-corruption tools and actions presented here.

enforce laws. Fortunately, actions to curb corruption within the sector are already being taken, by companies themselves, by the banks and export credit agencies (ECAs) that fund infrastructure projects, by civil society and by governments. A few of these initiatives, such as Transparency International's Integrity Pact and the effort by leaders of some of the world's largest construction companies to agree on corporate anti-corruption principles, were outlined in Chapter 1 (see pages 9–27).

None of these actions by itself will change the situation. Both public and private actors, and the banks and ECAs that finance projects, need to work together to eliminate corruption. This chapter addresses recommendations to the different actors involved in the sector which, if followed with rigour, could materially reduce corruption.

The recommendations distinguish between private and public clients because when it is public money that is being used to fund a project the standard of probity must be absolute. However, they acknowledge an overlap between the two spheres: a public contract is unlikely to be executed by the winning company exclusively, but rather by a web of subcontractors with potential for corruption at each private-to-private subcontracting level.

Many of the recommendations are not exclusive to the construction sector, but there are features of the sector, such as its size, complexity and importance to broader service provision, that render them all the more urgent.

1. Actions for clients (public and private sector)

(The term 'client' means the developer or owner of a project, and includes government departments and agencies in the case of public works).

- 1.1 Implement a code of conduct which commits the client and its employees to a strict anti-corruption policy.
- 1.2 Allow a company to tender for the client's projects only if the company has implemented a code of conduct that commits the company and its employees to a strict anti-corruption policy.
- 1.3 Maintain a blacklist of companies that have been found guilty of corruption. Alternatively, adopt a blacklist prepared by an appropriate international institution. Do not allow a blacklisted company to tender for the client's projects for a specified period of time after the offence (see page 59).
- 1.4 Require the use of a project integrity pact during both tender and project execution phases (see page 22).
- 1.5 Where not covered by integrity pacts, ensure that all contracts between the client and its contractors and suppliers require the parties to comply with strict anti-corruption policies.

2. Additional actions for public sector clients

(The following recommendations summarise Transparency International's Minimum Standards for Public Contracting, see page 4).

- 2.1 Public contracts above a relatively low threshold should be subject to open com-

petitive bidding. Exceptions must be limited, and clear justification must be given for selecting any other method.

- 2.2 The contracting authority must provide all bidders, and preferably also the general public, with easy access to information about tender opportunities, selection criteria, the evaluation process, the terms and conditions of the contract and its amendments, and the implementation of the contract and the role of intermediaries and agents. Confidentiality should be limited to legally protected information.
- 2.3 In order to give a potentially aggrieved competitor the opportunity to challenge the award decision, a reasonable amount of time must be allowed between publication of the contract award decision and the signing of the contract.
- 2.4 Internal and external control and auditing bodies must be independent and functioning, and their reports should be accessible to the public. Any unreasonable delays in project execution should trigger control activities.
- 2.5 Contract 'change' orders altering the price or description of work must be monitored at a high level.
- 2.6 The contracting authority should separate functions, and ensure that responsibility for demand stipulation, preparation, selection, contracting, supervision and control of a project is vested in separate offices.
- 2.7 The contracting authority should apply the standard office safeguards, such as the four-eyes principle and rotation of staff in sensitive positions. Staff responsible for procurement processes should be well-trained and adequately remunerated.

3. Actions for construction and engineering companies

- 3.1 Implement a code of conduct that commits the company and its employees to a strict anti-corruption policy (see page 49 on the WEF initiative and page 40 on the FIDIC initiative). The code should contain management, training, reporting and disciplinary procedures.
- 3.2 Employ effective due diligence on agents, joint venture and consortium partners, subcontractors and suppliers, so as to be reasonably certain that they will not engage in corrupt practices in connection with the company's business.
- 3.3 Ensure that all contracts between the company and its agents, joint venture and consortium partners, subcontractors and suppliers, require the parties to comply with strict anti-corruption policies.
- 3.4 Where possible, enter into sector-wide and project-specific integrity pacts (see page 43 on Integrity Pacts). The pacts should be independently monitored, and should contain enforceable sanctions. In appropriate cases, relevant government departments and financing institutions should also join in the pact.
 - (a) A sector integrity pact is an agreement between companies working in the same sector to act with integrity when they compete against each other in tendering for projects.
 - (b) A project integrity pact is an agreement between the participants in a specific project to act with integrity in relation to that project. A project integrity pact

can have the following two components:

- (i) The pre-qualification and tender integrity pact is between the client, designer and all bidding companies.
- (ii) The project execution integrity pact is between the client, designer, certifier and the appointed company.

4. Actions for international financial institutions, banks and export credit agencies

- 4.1 Agree to provide finance or guarantees in relation to a project only if all key participants have implemented codes of conduct that commit them to a strict anti-corruption policy.
- 4.2 Agree to provide finance or guarantees only in relation to projects that are to be placed through competitive tender or a transparent procurement process.
- 4.3 Undertake greater due diligence to try to ensure that there is no corruption in relation to the project. Increase staff time and resources for supervision. Require full disclosure in relation to payments to agents and other intermediaries.
- 4.4 Maintain a blacklist of companies that have been found guilty of corruption (see page 59). Alternatively, adopt a blacklist prepared by another international institution. Deny project finance or credit support to blacklisted companies for a specified period of time after the offence.
- 4.5 Require the use of a project integrity pact (see page 49) during both tender and project execution phases.
- 4.6 Introduce reliable whistleblower protection.
- 4.7 Make all documentation relevant to the planning, approval and implementation of a project available to the public in a timely manner.

5. Actions for trade and professional associations

- 5.1 Publicly speak out against corruption.
- 5.2 Increase awareness amongst the association's members of corruption and its consequences through publicity and training.
- 5.3 Implement a code of conduct that commits the association's members to a strict anti-corruption policy. The code should provide a disciplinary mechanism under which members who breach the code are sanctioned.
- 5.4 Support the development and implementation of industry-wide anticorruption mechanisms.

6. Actions for auditors

Undertake greater due diligence during audits to try to ensure that companies and clients are not engaging in corrupt practices.

7. Actions for shareholders

- 7.1 Question the boards of companies and clients to ascertain whether the companies are at risk from the consequences of corrupt practices.
- 7.2 Refuse to invest in companies and clients that do not operate effective anticorruption policies.

8. Actions for government

- 8.1 Support the development and implementation of the above actions.
- 8.2 Support the undertaking of the following actions by an independent international body or bodies:
 - (a) The development and management of an international externally audited ethical standard that construction companies and clients can achieve if they adopt effective anti-corruption policies. Companies that breach the standard would lose their accreditation for a fixed period. Tender lists for public works would eventually include only companies that have the accreditation in place.
 - (b) The development and management of an accreditation procedure for independent assessors. Independent assessors would be skilled individuals who monitor the pre-qualification, tender and execution of projects to ensure as far as possible that they operate in an environment free from corruption. Independent assessors could be appointed under the contract, under integrity pacts, or by alternative appointment mechanisms.
 - (c) The provision of a corruption reporting service which would:
 - (i) receive reports on corrupt activities
 - (ii) pass these reports on to the appropriate authorities in the relevant jurisdiction
 - (iii) follow up reports with the relevant jurisdictions to ensure that they are being dealt with
 - (iv) publicise reports of corrupt activities on their website.
 - (d) The operation of a public, transparent and effective blacklist of companies that have participated in corrupt activities.
- 8.3 Ensure that a specialist corruption investigation and prosecution unit for the construction industry is operational and effective. If no such unit exists, establish one that:
 - (a) is staffed by personnel with experience of the construction sector
 - (b) is multidisciplinary, containing engineers, forensic auditors, quantity surveyors, programmers and lawyers
 - (c) has jurisdiction throughout the country
 - (d) has powers to search premises, seize documents and interview witnesses
 - (e) cooperates with the law enforcement agencies of other countries

- (f) cooperates with anti-money-laundering authorities
- (g) investigates all cases upon receipt of compelling evidence from companies, individuals, NGOs and dispute resolution tribunals
- (h) prosecutes cases where the investigation results in sufficient evidence
- (i) publicises prosecutions and convictions.

8.4 Improve the effectiveness of anti-money-laundering mechanisms so as to make it more likely that bribes paid in relation to construction projects are identified in the international banking system.

8.5 Sign, ratify and enforce the United Nations Convention against Corruption, and actively comply with the OECD Anti-Bribery Convention.

9. Actions for civil society organisations

9.1 Monitor the tendering and execution phases of public sector projects to try to ensure they are free from corruption. To do so, demand access to information relating to projects.

9.2 Work with the media to publicise concerns about corruption in the construction sector.

10. Actions for all participants

10.1 Work to increase transparency in the construction sector. The greater the transparency, the more difficult it will be to conceal corruption.

10.2 Report corrupt practices to the authorities, and to any applicable trade or professional association.