# Handbook

# Curbing Corruption in Public Procurement

TRANSPARENCY INTERNATIONAL
the global coalition against corruption

# Handbook for Curbing Corruption in Public Procurement

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## ABOUT TRANSPARENCY INTERNATIONAL

Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through close to 100 chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business, and civil society to develop and implement effective measures to tackle it.

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TRANSPARENCY INTERNATIONAL

## ABOUT TRANSPARENCY INTERNATIONAL INDONESIA

Transparency International Indonesia (TI Indonesia) was established in October 2000 as an NGO and not-for-profit organisation. Since then it has worked as part of the global efforts to eliminate corruption, and it has borne the mission to eliminate corruption by promoting greater transparency and accountability in government administration, business, and civil society in Indonesia.

Currently TI Indonesia serves not only in the Indonesian capital of Jakarta, but also in regional and field offices in 17 region. Our success has included the first ever district Integrity Pact in Solok District, Sumatra as well Aceh, Banten, part of East Java, part of South of Kalimantan, and part of South Celebes. TI Indonesia has published many books including guidebooks: Countering Bribery for Business Sectors and Corruption Perception Index in 21 cities of 2004, which periodically surveys Indonesia (due for release in 2006 Corruption Perception Index in 32 Indonesian cities), Political Party Finance, Campaign Expenditure Monitoring of 2004 Election, etc. and relevant studies: Tax Reform, Extracted Industry Initiative, National Integrity System has successfully on Political Finance Bill and General Election Bill advocacy.

TI Indonesia is governed by a Board of Directors, which is chaired by T Mulya Lubis, Ph.D and a Board of Supervisory Body, which is chaired by Arief T Soerowidjojo, Ph.D. The national secretariat is in Jakarta, Indonesia and is lea by General Secretary Rizal Malik, M.A.

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## ABOUT TRANSPARENCY INTERNATIONAL MALAYSIA

Transparency International Malaysia (TI Malaysia) is an independent, non-governmental organisation committed to the fight against corruption. TI Malaysia is an accredited chapter of the Berlin based Transparency International.

The vision of TI Malaysia is committed to the achievement of a socially just society within a sustainable, plural democracy that is free of corruption. TI Malaysia engages with the public sector, private sector and civil society through various programmes for advocacy, education, information, and research to combat corruption.

The five year strategy plan of TI Malaysia from 2006 to 2010 focuses on organisational development, advocacy, education and training, surveys, media relations, publications, and regional networking. Policy advocacy is aimed at improving the institutional pillars of the National Integrity systems, reviewing anti-corruption policies and laws and promoting greater transparency and accountability in public contracting and procurement.

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## ABOUT TRANSPARENCY INTERNATIONAL PAKISTAN

Transparency International Pakistan (TI Pakistan) is the Pakistani chapter of Transparency International, established in 2002 with main aim is to strengthen the global value system by making transparency and accountability more relevant public norms. Transparency International Pakistan realises that presently public procurement in all departments of Pakistan is treated as a downstream, clerical, buying and selling function and, therefore does not attract professionalism and competent staff to deal with the meagre resources with integrity and transparency. One of the main reforms TI Pakistan has been working on since 2002 is to professionalised the organisations and individuals responsible for procurement through targeted capacity building activities. This is the core element of the initiative, addressing not only capacity building efforts at the level of agencies and individuals, but also to strengthen systems, transparency, and to tackle corruption.

Working in collaboration with other stakeholders, departments, TI Pakistan regularly published research papers, reforms, and reform manuals with aim to disseminate information for all stakeholders, and also conducts capacity building workshops in public procurements. These publications are available online on the website.

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## INTRODUCTION

This Handbook for Curbing Corruption in Public Procurement is meant to be a basic introduction for all stakeholders to the challenge of overcoming corruption in the field of public procurement. Our intention is to provide the readers with real world examples of successful actions that have been taken against corruption in a variety of Asian countries. The hope is that these experiences can be "translated" and "exported" to other situations and countries with similar success. This Handbook is the report resulting from the European Union – Asia Urbs Programme, which provided funds for cross-sectoral workshops on improving public procurement in the three Asian countries described in this Handbook.

In almost all countries, public procurement through government contracting represents a large if not the largest percentage of the economy. This translates into a vast amount of money, which provides seemingly endless opportunity and temptation for corruption. The situation regarding public procurement differs widely throughout the world, and in all countries involves a complicated set of regulations and practices. This makes the area more opaque and the challenge for anti-corruption advocates even greater.

This challenge demands very aggressive and very intelligent tools, and Transparency International has accepted the task of developing such tools. Several of these are described in the following pages. It is extremely important to note that the very diverse world of public procurement leads to diverse corruption and requires diverse responses. There is not a "one size fits all" response, and even the most effective mechanism will not necessarily work immediately or all the time. We encourage you to read the following historical and legal stories, and to think how they are similar or different to the story in your own country. Then read about how civil society and governments have worked together in Indonesia, Malaysia, and Pakistan to improve the public procurement agencies and processes. Perhaps similar techniques can be applied in your own situation, but very likely many details will need to be altered. In doing so you

will become involved in the evolving dynamic that is the struggle for better and cleaner governments and businesses and in turn less corrupt societies.

This Handbook is broken down into Part I, which is meant to be a "global introduction" to procurement. Part II is further subdivided into three country chapters: Indonesia, Malaysia, and Pakistan. Each of these chapters includes descriptions of the legal and historical context of corruption in public contracting in their country as well as the various steps that have been taken to work against it.

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# PART I
## How to Reduce Corruption in Public Procurement:

# The Fundamentals

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## INTRODUCTION

Procurement of goods, works and other services by public bodies alone amounts on average to between 15% and 30% of Gross Domestic Product (GDP), in some countries even more. Few activities create greater temptations or offer more opportunities for corruption than public sector procurement. Damage from corruption is estimated at normally between 10% and 25%, and in some cases as high as 40 to 50%, of the contract value.

Public procurement procedures often are complex. Transparency of the processes is limited, and manipulation is hard to detect. Few people becoming aware of corruption complain publicly, since it is not their own, but government money, which is being wasted.

The purpose of Part I of this *Handbook for Curbing Corruption in Public Procurement* is to provide an overview of the problem of corruption in public contracting (Section 1) and to offer suggestions and experiences of how this problem can be addressed (Sections 2 and 3). It addresses public authorities as well as private sector actors, such as bidders, suppliers, contractors and consultants.

## SECTION 1 THE PROBLEM OF CORRUPTION IN PUBLIC PROCUREMENT – AN ANALYSIS

### 1.1. THE TERM PROCUREMENT

"Procurement" refers to the acquisition of consumption or investment goods or services, from pencils, bed sheets and aspirin for hospitals, gasoline for government cars, the acquisition of car and truck fleets, equipment for schools and hospitals, machinery for force account use by government departments, other light or heavy equipment or real estate, to construction, advisory and other services (from the construction of a hydroelectric power station or expressway to the hiring of consultants for engineering, financial, legal or other advisory functions).

"Procurement" for the purposes of this Handbook is defined broadly as the preparation, award and implementation/administration of contracts for goods, works and other services and thus covers not just the narrow selection of a contract partner by a purchasing body and the actual entering of a contract between the two, but the entire process from needs assessment through preparation, award and implementation/ administration of contracts for goods, works and other services such as consultant services of a technical, financial, legal or other nature.

The proposals developed in this Handbook for the purpose of cleaning up procurement processes can be applied *mutatis mutandis* for processes for the issuance of licenses (e.g. to operate certain public or quasi-public services), permits (building, restaurant, alcohol or residence or other permits), concessions (for the extraction of natural or other resources), and equally in the selection of purchasers of public assets in state-operated privatisation processes.

"Public procurement" refers to all contracts between a government (government department, publicly owned corporation and other types of agencies) and companies (public or private) or individuals.

Finally, while the Handbook deals primarily with *public* procurement, the issues are very similar with regard to private-to-private contractual relationships.

## 1.2. DEFINITION OF CORRUPTION

Transparency International (TI) defines corruption as "the misuse of entrusted power for private gain". "Private gain" must be interpreted widely, including gains accruing i.e. to an economic actor's close family members, political party and in some cases to an independent organisation or charitable institution in which the economic actor has a financial or social interest. This is the definition used for the purposes of this Handbook.

There rarely are criminal code definitions of corruption. Instead

criminal (penal) codes normally contain a mix of crimes that all together are considered as corruption, e.g. bribery (the giving as well as the receiving) of local or foreign government officials and private companies, facilitation payments, fraud, bid submission fraud, embezzlement, theft, collusion among bidders, bribery of parliamentarians etc. Activities that are considered illegal in one country may not fall under the criminal code provisions of another country; they may still be considered "corruption" in both countries.

Political corruption is often associated with the electoral cycle and relates primarily to election funding, or with the direct effort to buy a politician's vote or decision, either in a parliamentary vote or outside of it (such as in a parliamentary committee). Political corruption often manifests itself as lobbying or as extortion, but also through "revolving-door" moves of senior politicians directly into high business positions, often in companies whose activities were previously regulated or controlled by the same politician. In the context of this Handbook, "political corruption" refers to the involvement of politicians (rather than officials) in the procurement processes.

Corruption often is called a "control crime": Since both the bribe giver and the taker are criminals, both try to keep the crime covered up, and only control efforts by the authorities will lead to disclosure of the facts and eventual prosecution.

## 1.3. FORMS OF CORRUPTION

Corruption in public procurement can happen in many different ways. These range from the most common form of upfront bribery and facilitation payments to more subtle forms of political corruption.

### Bribes vs. Facilitation Payments

Bribes are usually larger amounts given to senior officials (decision makers) to obtain a favourable decision where no right or claim to such decision exists, whereas "facilitation payments" usually are relatively smaller amounts paid to usually lower level officials to accelerate/facilitate

a decision to which the payer often has a legal claim (customs clearance of luggage or machinery) but which may be unduly delayed or withheld pending some payment. Both are forms of corruption and constitute illegal behaviour in most countries.

### Supply vs. Demand

The initiative for bribing can originate with the bribe giver or the bribe taker; the latter case (also called extortion) often is referred to as "passive corruption", but this term is misleading since the extortionist often enough is everything but "passive".

### Cartel or Collusion

Bidders often form a cartel, which then tries to manipulate the award decision in favour of one of their members, with or without the involvement of a corrupt inside official. Collusion agreements can include, for example, assigning "turns" among the cartel members for winning public bids, or agreeing to internal compensation payments for submitting high or other "failed" bids.

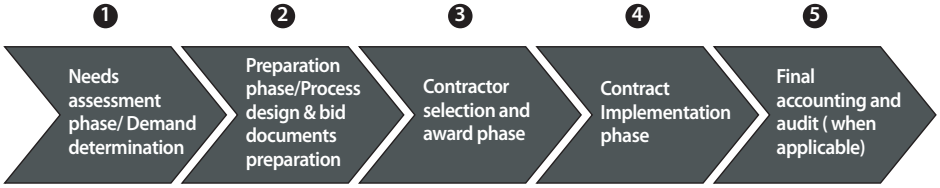
### Structural vs. Situational

Corruption in a business context usually is "structural", meaning it is well planned and prepared and carried out systematically. Occasions for "situational" corruption are unplanned, e.g. when a person driving a car under the influence of alcohol is caught by the police and offers the policeman a bribe so as to induce him not to write a ticket.

## 1.4. MANIFESTATIONS OF CORRUPTION IN PUBLIC PROCUREMENT

### *1.4.1. CORRUPTION RISKS AND MANIFESTATIONS ACROSS THE PROCUREMENT CYCLE*

Corruption and corruption risks can take place along the entire cycle of public procurement. The cycle includes the following most common phases:




Risks and manifestations of corruption may be different in each phase. A wise strategy to prevent or control corruption in this field will recognise the differences in these stages and will be attentive to red flags as triggers for corrective action (or due diligence) as will be indicated later in this Handbook.

A very important aspect to consider when analysing corruption risks, is to differentiate problems related to inefficiency or to basic lack of capacity (error) from pure corruption. While a "bad" outcome may originate in any of the three, the approach taken against it needs to consider more precisely the reasons why it happened, in particular if there can be criminal actions involved. Not all efficiency problems are related to corruption, and vice versa; and what can look as corrupt, may also be simple error. This distinction is also important as some efficiency-driven reforms may, however, undermine transparency-building efforts. For example, if the goal of a particular reform is speeding up procurement processes, and due attention is not given to transparency issues, a recommendation to reduce publication and evaluation time may backfire. It also works the other way around. Advocating for transparency measures that will render the process inefficient will not achieve their purpose either.

The following are some examples of the most usual manifestations of corruption and corruption risks at each stage:

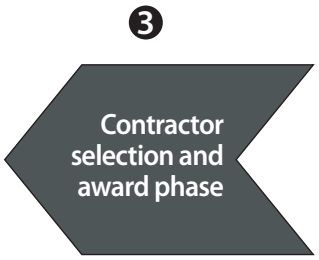
**1 Needs assessment phase/ Demand determination**

- The investment or purchase is unnecessary. Demand is induced so that a particular company can make a deal but is of little or no value to the society.
- Instead of systematic leak detection or grid loss reduction (both of which offer little reward), new capacity is installed (which offers bribe potential).
- The investment is economically unjustified or environmentally damaging.
- Goods or services that are needed are overestimated to favour a particular provider.
- Old political favours or kickbacks are paid by including in the budget a "tagged" contract (budget for a contract with a "certain", pre arranged contractor).
- Conflicts of interest (revolving doors) are left unmanaged and decision makers decide on the need for contracts that impact their old employers.

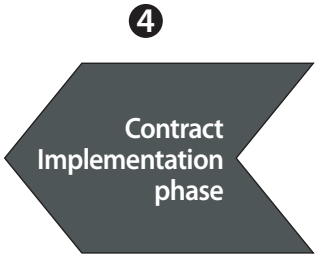
**2 Preparation phase/Process design & bid documents preparation**

- Bidding documents or terms of reference are designed to favour a particular provider so that in fact, competition is not possible (or restricted).
- Goods or services needed are over- or underestimated to favour a particular bidder.
- Unnecessary complexity of bidding documents or terms of reference is used to create confusion to hide corrupt behaviour and make monitoring difficult.
- Design consultants prepare a design that favours a particular bidder.
- Grounds for direct contracting are abused.

- Decision makers are biased (bribes, kickbacks, or conflicts of interest are involved).
- Selection criteria are subjective in ways that allow biases to play a role and remain unattended.
- An advantage to a particular bidder is granted through the exchange of confidential information before bid submission or during the clarification period. Clarifications are not shared with all the bidders.
- Confidentiality is abused and extended beyond legally protected information making monitoring and control difficult.
- The grounds for the selection of the winner are not made public (transparency of bid evaluation).
- Excessive (unnecessarily high) price as a result of limited or non-existent competition.




- Winning bidders/contractors compensate bribes and other extra payments with poor quality, defective or different specifications than those contracted. Faulty or sub-specification work execution, requiring early repairs or expensive correction.
- Contract renegotiation or "change orders" introduce substantial changes to the contract, often in small increments that can be decided by site engineer.
- Price increases during execution through "change orders" reflecting changes in specifications or cost increases, facilitated often by collusion between corrupt contractor and corrupt control official.
- False or inexistent claims are filed.
- Contract supervisors or monitors are "bought" or are not independent and willing to justify false or inexistent claims.
- Contract renegotiation is allowed or performed introducing substantial changes that render the bidding process useless.



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**Needs assessment phase/ Demand determination**

- Accountants doing final accounts and Auditors are biased or "bought" and willing to support false certificates.

In TI's experience and research, the early and late stages of the procurement cycle are increasingly exposed to corruption.

Among the most important areas of increased risk are[1]:

- Limited or restricted access to information;
- Abuse of exceptions to open public bidding;
- Limited or ineffective control and monitoring within the contracting process and particularly during the contract implementation phase; and
- Deficiencies and lack of transparency during the budget phase.

### *1.4.2. SPECIAL RISK FACTORS*

In addition to the inherent corruption risks and manifestations within the procurement cycle, there are particular factors and circumstances that have the potential to increase such risk. Below, a description of the most salient ones:

**"Urgent Purchases" at End of Fiscal Year**

Urgent purchases made at the end of a fiscal year often are subject to corrupt practices, most likely due to the fact that transactions in this period are less strictly controlled. In many public sector agencies the unspent portions of the public budget are lost at the end of the fiscal year. This creates pressure to spend unspent monies before this happens. Sometimes this is called an "emergency" situation in order to be able to use direct contracting procedures when otherwise only open bidding would be possible.

## "Emergency" Responses to Natural Disasters and Other Such Events[2]

There is a widespread perception that procurement and logistics in disaster cases is particularly at risk from corruption because of the large sums of money usually involved, particularly in the case of capital intensive sectors such as the provision of shelter and water and sanitation. This perception has led to considerable investment by humanitarian organisations in measures to mitigate the risk through the strengthening of logistics systems, in the recruitment of professional logisticians and staff training[3].

Procurement activities in emergency situations often takes place in difficult environments, including war zone in which aid may be caught up in the dynamics of the conflict, and with enormous pressure to deliver relief quickly, potentially increasing the risks of corruption.

The issue of corruption in emergency situation must be seen in the context of other competing management priorities and there may well be a need for considered, documented trade-offs, such as between efficiency and economy. However, one should address these corruption risks essentially through good management and greater levels of accountability and transparency to disaster affected populations.[4]

## Inadequate Access to Information

Corruption thrives in obscurity. Wherever a government has neither a dynamic pro-active information policy nor a proper

[1] Detailed results of the application of the Public Contracting Monitoring System, a methodology developed by Transparency International to measure corruption risk in public procurement systems, can be found at: http://www.transparency.org/regional_pages/americas/contrataciones_publicas/diagnostico_y_medicion .

[2] For more detailed recommendations on strategies to address and prevent corruption in Disaster relief and other emergency situations consult, as well as http://www.u4.no/themes/ces/main.cfm ("Corruption and public procurement in aid-funded emergency relief).

[3] Thomas & Rock Kopczak, 2005.

[4] Ewins, Pete, Harvey, Paul, Savage, Kevin & Jacobs, Alex; 2006. For additional information on this subject, please see the References at the end of this Chapter.

freedom-of-access-to-information law that is actually implemented and operational, the lack of information about government activity and decision-making can easily hide corrupt manipulation of such decisions. Therefore transparency and access to information are considered essential ingredients of any effort to reduce corruption in a society. Access to information can actually be provided efficiently and in many cases at moderate cost by using Internet websites but also at the local level using traditional means like billboards, radio announcements etc.

### Use of Standard Bidding Documents

Standardised bidding documents and other procurement documentation provide for predictability and systematic treatment. If non-standard bidding documents are used instead, it opens the door to manipulation and leads to opaque decision-making.

### Preferences to Selected Bidders

Granting preferences of any kind to certain groups of bidders always risks undermining the fairness of the procurement process, and certainly adds costs to the purchaser. If preferences are to be provided, it is essential that they are clearly regulated and transparently administered strictly in accordance with clear enacted rules. For example, when countries or organisations give "buy local" preferences, such as are allowed by the World Bank for suppliers and contractors in developing countries, they should be fully transparent to all bidders from the outset as to amount/percentage and who qualifies for the preference.

### Participation of Official-Owned Companies

The participation of bidders owned fully or partly by government officials can introduce additional risks if appropriate systems for transparency and accountability are not ensured. Especially problematic is that sometimes the public ownership of a company is not disclosed. Special due diligence is required to make sure that such bidders are treated exactly like every other bidder; if it is possible that the publicly owned bidder had inside information available while preparing the bid, the company should be excluded. Some red

flags that should trigger additional due diligence for official-owned companies include the following[5]:

- Opaque company ownership structure for companies winning sizable and recurrent
  government contracts;
- Family members of senior government officials holding ownership and management
  roles in a company;
- Civil Society knowledge of government or government official ownership of business
  entities; and
- Recurrent appearances of government officials at company headquarters.

**Participation of Front/Shell Companies**

Front or shell companies are corporate structures that are not really operational and are created basically to help mask or hide true ownership. They provide disguise for government officials, their families, sub-contractors or collusion agreements by bidders. According to the World Bank, some of the "red flags" that indicate the existence of a front or shell company include[6]:

- Previously unknown entities serving as subcontractors on a large project;
- The company is registered in a jurisdiction that allows secrecy regarding ownership, management etc;
- The company requires payment of invoices in a jurisdiction which protects secrecy;
- There exists no visible performance history of the company;
- Opaque ownership structure;
- Owners listed are law firms or incorporation agents;
- Lack of visible corporate facilities;

[5] These red flags have been directly quoted or inspired from "Corruption in Public Procurement: A perennial Challenge." by Ed. Campos et al, in "The Many Faces of Corruption" World Bank. Forthcoming 2007. The article contains further detail on red flags and corrupt practices and the publication is a good reference for corruption and anti-corruption in different sectors

[6] Ibid.

- The point of contact for a company is a personal residence or a telephone answering service; and
- No creditable performance record can be found through routine database review.

### *1.4.3. ROLE OF LENDERS, FUNDERS AND GUARANTORS*

#### International Financial Institutions (IFIs)

IFIs such as the World Bank, the Asian Development Bank, the African Development Bank, the Inter-American Development Bank, the European Bank for Reconstruction and Development and national development banks (like the Kreditanstalt für Wiederaufbau in Germany) have developed over the years their own rules for procurement of goods and services with resources provided by them. The World Bank's Guidelines for Procurement (including the Guidelines for the selection of Consultants) provide the most complex and thorough binding system, which has to some extent been adopted by the other IFIs as well. These guidelines establish a system, which succeeds in reducing corruption, but of course the system is operated by people (in governments, by bidders and by the staff of the IFIs) and thus is vulnerable. Occasionally IFI staff is involved in bribery schemes, acting on behalf of one or more of the bidders or on their own behalf. More often, such financiers contribute (unwillingly?) to corruption by their reluctance to allow full transparency of their own contributions to the procurement processes. Although there are several aspects of the World Bank Guidelines that can still be improved, they currently are the best international standard.

#### Export Credit and Export Credit Guarantee Agencies (ECAs)

Most governments promote the exports and international investments of domestic businesses by providing them with financial support in the form of credit or insurance for export or investment activities. ECAs provide backing for many infrastructure projects and key sales and purchases around the world. In the past only ECAs in OECD member states have made some effort to identify corrupt

deals and deny cover to them. These efforts have been strengthened through the April 2006 Action Statement issued under the auspices of the OECD Export Credit Working Group. . While its homogenous application across the globe still remains a challenge, the Action Statement 2006 provides important tools to prevent and control corruption in international business transactions including:

- The requirement that ECAs inform exporters of the legal consequences of bribery;
- The requirement that companies submit with the application for cover a declaration to the effect that the contract to be funded or guaranteed has not been obtained through bribery or corruption;
- The possibility for ECAs to implement effective sanctions and other appropriate measures in case of violations;
- The possibility for ECAs to request from exporters information on agents, their fees and mandates; and
- The possibility that ECAs publicise the applications for cover and the actually approved cover.

**Commercial Banks**

Commercial banks can, but rarely do play an important role in the prevention and control of corruption in business transactions. Commercial banks are often in possession of relevant information that can provide accurate signals of corrupt-to-be deals like the engagement of agents overseas at absurd fees and under unclear contracts, money flows to tax havens and uncommon ownership structures. Commercial banks are well equipped to pursue due diligence on their clients and should be encouraged to be more interested in reducing the financial risk associated with corruption risk.

**Official Donors**

Donors have a key role in promoting transparency and accountability both in the overseas activities they fund and also within their own operations. All governmental donor agencies have their own procurement regulations but considerable lack of

transparency exists further down the supply chain of donor-funded projects. Difficulties arise when lack of harmonisation between donors introduces difficulties on the ground by subjecting projects to multiple and diverse regulations, and at the expense of local institutional development. These and related issues have been discussed in depth under the rubric of 'increasing aid effectiveness' and the way forward is found in the 2005 Paris Declaration on Increasing Aid Effectiveness which was signed by the vast majority of donors and aid receiving countries.

The Paris Declaration (accompanied by measurable indicators of progress) includes commitments by developing countries to use mutually agreed standards and processes to carry out diagnostics and medium and long-term procurement reform. Donors have committed to progressively rely on partner country systems for procurement when the country has implemented mutually agreed standards and processes and to adopt harmonised approaches when national systems do not meet mutually agreed levels of performance.

The OECD-DAC Joint Venture on Procurement, working collaboratively with the World Bank and key procurement counterparts in developing country governments, is to provide a four point scale rating (A to D) of all country procurement systems. Existing data are being retrofitted to create a baseline for 2006, and the baseline indicators have been agreed in version four of the OECD Benchmark and Assessment Tool for Public Procurement Systems.

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### *1.4.4. ACTORS IN CORRUPT DEALS*

Corrupt deals require the involvement of different actors depending on the form of corruption used. Bribery and facilitation payments require a giver and a taker, often a "facilitator" and, depending on the amount, someone providing a safe haven for the money or to facilitate a money laundering scheme. Below are a few notes on corrupt deals' participants.

**Official** (representing a public authority, a government department) is usually called the **Employer** or the **Principal**. The Employer either takes the criminal initiative and extorts a bribe from the bidders before making official decisions in their favour, or is the recipient of a bribe initiative originating from one or more of the bidders and accepts a bribe in exchange for such a favourable decision.

### Bidders (Suppliers, Contractors, Consultants) and Sub-contractors

Economic operators wishing to do business with the government, supplying goods or services, either take the initiative offering/giving a bribe or any advantage to a government decision maker in order to obtain a favourable decision, or give in to extortion demands from a corrupt official.

### Agents, other Middlemen, Consultants, Joint Venture Partners, Subsidiaries

Economic operators wishing to manipulate a government decision-making process often refrain from committing the criminal acts directly themselves but utilise agents, "consultants", "contractors", other local middlemen, or local subsidiaries or joint venture partners for the actual bribe activity. The contract with the agent usually is vague as to purpose, control, disclosure, accountability, success factors etc. and often provides for payment into numbered accounts in tax havens, giving thus a clear indication of the criminal intent of the contract.

### High Share of Managers (as distinguished from lower level staff)

Experience in industrial countries shows clearly that - apart from facilitation payments - the majority of corrupt people (both on the private and the government side) are not junior or subordinate staff, but people in the higher echelons, including many senior managers.

### Politicians

Politicians (especially at municipal level) often have a double political-administrative function (e.g. City Councillors) that results in a complex legal position as regards corruption (i.e. whether they are regarded as "officials" under the penal code or not).

### Financial Safe Havens

Corruption would be much more difficult if opportunities to hide its benefits or to launder corrupt money didn't exist.

### Witnesses

All those who have information about corruption have the power to stop it, and keeping silent is close to participating in it. Increasingly, whistleblower motivation and protection mechanisms, anti-corruption hot lines and other systems aim at making it easier for people who want to see things changing.

## *1.4.5. IMPACT OF AND DAMAGE FROM CORRUPTION IN PUBLIC PROCUREMENT*

The ultimate goal of public procurement is to satisfy the public interest. Like any government action should be. In this sense, good procurement should satisfy the needs of the people, should be fair to businesses, should save (and avoid waste!) of public funds. Good public procurement is a good tool to implement public policy in all areas, and should be an instrument for good governance and therefore good government. In this sense, good procurement will contribute to the government's legitimacy and credibility.

On the contrary, corrupt (bad) public procurement will increase poverty and inequality by diverting funds away from the attention of social needs; it will engender bad choices, encouraging competition in bribery rather than in quality or price. For companies, corrupt procurement will provide an unfair, unstable and risky competitive advantage and will create a sort of market-entry cost or non-tariff barrier, at least for those companies who do not wish, or cannot afford to bribe their way in.

There are different aspects in which the impact of corrupt procurement can be identified. Below, the main ones are outlined.

### Financial Impact

Financial impact or damage can consist of:

- Unnecessarily high cost of purchases, investments, services, or unnecessarily low income from licenses, permits, concessions etc.;
- Sub-specification quality of supplies or works, not justifying the price actually paid;
- Burdening a government with financial obligations for purchases or investments that are not needed or are not economically justified at all or are oversized; and
- Burdening a government with early repair costs to repair and maintain investments, which are too recent to justify or explain such maintenance costs.

For example, a study performed in 2005 by TI Czech Republic at the national and municipal level[7] indicated that an estimated 32.4 billion CZK (over 1.1 billion EUR) in public funds are lost per year to corruption[8].

### Economic Impact

Economic impact can consist in burdening a government with operational, maintenance and debt servicing liability for investments/purchases, which do not contribute positively to the economy of the country. Further economic impact can happen when capital investment levels decrease because of corruption costs and threats to business operators, thus affecting economic growth and employment.

[7] Sources used were the Supreme Audit Office, the Ministry of Finance and public services at the municipal level.

[8] Additional Information can be found at Transparency International - Czech Republic: Chlumcanskeho 5, 180 21 Prague 8 (David Ondracka or Adriana Krnacova) . Tel: +420 266 790 115; Tel: +420 266 790 117; fax: +420 284 682 872. E-mail: ondracka@transparency.cz. http://www.transparency.cz .

### Environmental Impact

Corruption in procurement can engender bad choices, among them projects that have adverse environmental impact. In implementing an investment project which does not comply with the country's (or international) environmental standards, the damage may consist in unnecessary or increased environmental or health risks or actual damage, financial liabilities, or long-term adverse impact on the environment.

### Impact on Health and Human Safety[9]

Damage can consist in human health and safety risks due to quality defects, environmentally unacceptable investments or non-compliance with environmental or health standards. Corruption-induced sub-standard construction can lead to building failure and consequent human losses.

### Impact on Innovation

Corruption inducted lack of competition leads to the neglect of innovation. Companies relying on corruption will not spend resources on innovation, and even non-corrupt companies will feel less inclined to make the necessary investments in innovation if they cannot access markets due to corruption.

### Erosion of Values

When people observe lack of concern for integrity and the common good among senior officials and private sector economic operators, and reckless and corrupt behaviour is not being sanctioned, they easily reduce their own integrity standards, out of need and often out of greed. This applies also to other economic operators who realise that offering a competitive price and quality are not adequate requirements for obtaining contracts.

### Erosion of Trust in Government

When people observe that reckless corrupt behaviour among government representatives is not being sanctioned, they conclude quickly that government in general is not to be trusted and that cheating government is morally acceptable and not against common values.

### Damage to Honest Competitors

Corruption by corrupt bidders, if successful and not sanctioned, damages and possibly destroys the honest competitor and may well lead to job losses on the part of an economic operator who is better and more innovative than the corrupt bidder who is not willing to rely on quality and price of his product but resorts to corruption to obtain contracts.

### Serious Danger to Economic Development

If a government commonly allows corruption in the context of purchases and investments, and often selects investment projects not on the basis of their contribution to economic development of the country but on their ability to generate bribe payments, a country may soon end up squandering investment opportunities and external development assistance and thus seriously retard the country's economic development. The ultimate victims are the poor people in the country.

[9] For further information on the impact of corruption and health and also more details on corruption in health related procurement and the pharmaceutical industry, consult TI's Global Corruption Report 2006.

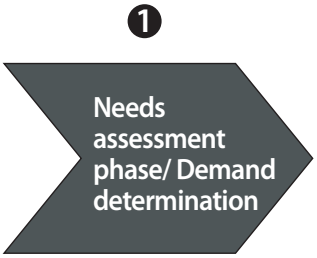
## SECTION 2 WHAT CAN BE DONE ABOUT IT? ANTI-CORRUPTION STRATEGIES AND INITIATIVES IN PUBLIC PROCUREMENT

### 2.1. CRITICAL STEPS FOR TRANSPARENCY ACROSS THE PROCUREMENT CYCLE

As explained previously, the procurement process typically consists of five separate **phases**. Each of these phases is vulnerable to corruption and needs to be addressed separately. In this section we discuss relevant issues, warning signs (red flags) and actions that can be taken in each stage to address those vulnerabilities.

#### Needs Assessment Phase / Demand Determination

In this phase, the critical issues are to make sure that the goods and services to be purchased or the investment to be made is socially and economically justified and that the best of the various alternatives is chosen to meet the assessed need.




During this stage, special attention should be placed into the following **questions**:

- Are the goods or the services to be acquired needed at this time?
- For investment projects: Is additional capacity truly needed, or could the demand gap be met by better performance on reducing losses or effecting repairs in the existing system?
- Is the planned capacity or quantity or extent of the service actually needed in the foreseeable future (in order to avoid unneeded or oversized project investments)?
- What are the optimal location, capacity and design for the investment?

**Things to Do During the Needs assessment Phase:**

- In many cases there are consultants hired for this stage and the next one. The key at this stage is therefore:
  - The transparency of the process by which they are contracted; and
  - The independence with which they operate (possible conflict of interests).
- Enable public (civil society) participation at this stage of the decision making process. One way could be through public hearings but also through other means of open consultation processes. This allows to:
  - Check the need;
  - Enable accountability; and
  - Identify necessary/unnecessary elements of the goods, services or investment to be acquired.

Few governments are equipped to make decisions about needs assessment and magnitude or quantities of investment on major investment (infrastructure) projects with their own staff. Most resort to the employment of consultant engineers or investment bankers to assist the government in the process. The issue here is to make sure that the consultants selected for this job are truly independent and not, for example, (formally or informally) associated with one or more suppliers or contractors, and thus under temptation to recommend solutions which would benefit their associates. Thus only consultants should be allowed to participate in the selection process who can confirm their independence and who are willing to commit themselves to select and design an investment which is not biased in favour of a particular supplier or contractor. In addition a special prohibition can be introduced, by which the consultants who participated at this stage cannot participate during the bidding process (this is if the nature of the market or investment allows).

This phase should be subjected to thorough **transparency**, so as to allow all stakeholders to contribute to the investment selection, location

and design process, and to focus public attention on any economic, financial, environmental, social or civil or human rights concerns. **Public hearings** may be particularly suitable in this phase to assure that public concerns are fully invited and reflected (see 3.3 for more details on Public Hearings). Before the design and preparation phase begins, the results of the needs assessment should be made **public**; for very large investments the results should be publicly debated and commented.

**Things to Do:**

- Public hearings to discuss the design and the bidding documents. This allows the public to comment on the design and the potential bidders to express in advance their concerns and identify potential problems in the bid design that could favour just one bidder; and
- Pro-active disclosure by government agencies of relevant information via website

**Red Flags or indicators** of potential manipulation during this stage are the following

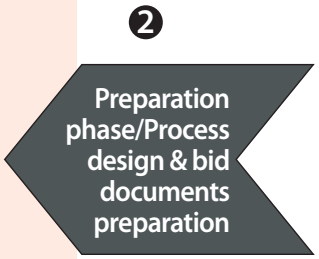
- Non transparent procedures and decision-making which cannot be monitored and controlled by the public,
- Inadequate access of the public at large (including in particular the civil society) to information about government programmes, processes and decisions,
- Absence of opportunity for public discussion of government programmes and decision making; and
- In privatisation processes, unclear, possibly intentionally imprecise and vague goals and criteria for the privatisation programme or in-transparent, unexplained, not market-based assessment of the value of the enterprise.

## The Preparation Phase Design and Bid Documentation Preparation

Most of what has been said about the previous phase applies equally to this second phase of the process: The consultants need to be scrupulously independent, and the public should have full access to the process.

During the process of preparing the design and the bid documents, advertising the process, possibly pre-qualification and the submission of bids, **red flags or indicators** of potential manipulation could be the following[11]:

- Absence of, or non-compliance with, a procurement plan;
- Contracts for similar goods are not packaged but split;
- Justification for direct contracting not given or a fake one given;
- Deviation from standard bidding documents;
- Technical specifications are weak and do not allow for evaluation of the contractors' quality of performance;
- Bid specifications are narrow or appear tailored; references to work being performed to "National Standard Specifications" in place of more detailed descriptions;
- Global procurement notice not issued;
- Restricted advertising or insufficient notice given;
- Advance release of bid documentation or relevant information to one bidder;
- Vague or unclear pre-qualification requirements;
- Insufficiently advertised;
- Inadequate time given for preparing applications;
- Lack of publicly known standard evaluation procedures;
- Exclusion of experienced applicants on minor technicalities;




[11]For more information on these points please refer to the World Bank .

- Requirement to be pre-registered on a government-approved roster;
- Failure to answer requests for clarification in good time;
- Only selected bidders are informed of the employer's contract cost estimate;
- Failure to keep accurate minutes of pre-bid meetings, including questions and answers;
- Clarification sought by bidders is not answered in writing nor circulated to all bidders;
- Delay between deadline for submitting bids and opening them;
- Different location for receiving bids and opening them;
- Bids submitted and accepted after the submission deadline;
- Bids not opened in public;
- Names of attendees, names of bidders and offer prices not recorded at bid opening;
- Failure to provide secure storage of, and restricted access to, bids received; and
- Lack of transparent procedures for handling complaints and determining remedies.


### The Contractor Selection and Award Phase:

The selection of the supplier / contractor / consultant / licensee should be on the basis of public competition, for larger investments public international **competition**, as the proven way to obtain the lowest evaluated bid. The "lowest price" is not necessarily the lowest evaluated bid or most economic bid, considering that bidders may bid below their expected cost, in the expectation that once in the job, they will be able to obtain price increase.

**Things to Do before the Procurement Process Starts:**

- Debarment: Exclude from bidding processes bidders that have been involved in corrupt deals;
- Implement Integrity Pacts before the process has started (ideally starting in phase 1); More information on integrity pacts below;
- Use open competitive bidding whenever possible. Use non-competitive processes (restricted bidding or direct contracting) only where truly justified and fully explained and documented;
- Ensure that during the bidding clarification phase (questions and answers), the questions and the answers given are shared with all the bidders and not just given to a few;
- Restrict or manage contact between bidders and procurement staff or members of the decision committee to avoid unclear situations to both and the other bidders;
- Set up and use a conflict of interests register for officials that allows managing possible conflicts of interests with bidders and officials involved in the selection and decision making processes;
- Develop and use strict **rules regarding civil servants** that ensure they are well selected, trained, paid, supervised and controlled, that they have to provide disclosure of assets and income (their own and their families), and that outside jobs require approval; and
- Develop Red Flags for **staff** such as
  - Expensive lifestyle unexplained by known income;
  - Frequent social contacts with suppliers and contractors and other clients;
  - Unapproved external jobs;
  - Absence of complaints where complaints are to be expected;
  - Frequent award of contracts to the same bidder; and
  - Unexplained and undocumented delays in the process as compared to the time plan.

The **Procurement *Guidelines of the World Bank*** are an example of procurement regulations that have proven their value and quality since they provide the best available assurance that the selection process leads to the best possible result in the circumstances. Under the Bank's Guidelines, bidders today can (and should) be required to provide integrity assurances and to disclose any convictions or investigations relating to corruption violations. If any such convictions or investigations exist, the bidder may be excluded from participation in the bidding process.

Additional safeguards against corruption that governments might consider are provided by the application of the ***Integrity Pact*** concept to the bidding process (see in detail below 3.2.1), as it has been demonstrated quite successfully in a number of country situations. Another good option for governments is to extend civil service obligations to contractors and consultants as well as to private or semi-private companies providing formerly public services.

Occasionally, **limited public competition** or even **negotiated contracting** or **single source contracting** may be justified due to the limited number of potential bidders or if proprietary goods are being sought. Such exceptions, however, should be fully justified and recorded and thus available for review.

Frequently, however, governments put forward the argument of an "emergency" for abandoning competition requirements. Since this argument is often abused, it needs to be documented in detail: Only truly unpredictable natural or political disasters should be accepted as "emergency"; no situation where the "emergency" or "urgency" is self-inflicted or -induced should be allowed to justify the non-use of competitive bidding.

For major civil works contracts, the government may apply **pre-qualification procedures** so as to conduct the actual bidding process among bidders already cleared as to their financial and technical competence. In such cases, the integrity requirements should be applied during the pre-qualification phase, so as to assure that all potential bidders have submitted to appropriate integrity clauses.

**Bid Design, Conflict of Interests Management and Integrity Pacts in Argentina. Provision of School Supplies.**[12]

One interesting feature of the Integrity Pacts is how they can be implemented in less competitive situations (markets) by introducing transparency measures and even fostering the participation and accountability. This is the case for example of the IP implemented in Argentina in 2003 for the text book supply for the Ministry of Science and Education.

The Ministry of Education Science and Technology in Argentina (we will refer here to it simply as the Ministry) opened a process to buy 3,315,000 school textbooks for high school level. The text books were to be distributed among the provinces in Argentina among 1,815,000 students with scarce resources in public schools. The procurement process took place for a first attempt in 2002. The process was designed to have a competitive pre-qualification stage where the books were to be selected by a committee. During this stage, various publishing companies expressed concerns regarding the evaluation criteria used to select the texts, the qualities of the experts involved in the selection process, as well as the procedure within the provinces.

Based on these concerns, the process was later declared invalid. For the second attempt, the Ministry invited Poder Ciudadano, Transparency International's Chapter in Argentina, (here referred to as TI) with the task to introduce transparency into the process and to guarantee abundant and fair participation from all interested publishing houses.[13] TI introduced three elements into the process: First, an Integrity Pact among all participating publishing companies and the Ministry was implemented. The Pact introduced a level playing field by determining the same rules for all contestants. Its main purpose was to reduce the incentives and opportunities for bribery and corruption in this process.

[12] Transparency International: Stealing the Future – Corruption in the Classroom, 2005. For more detailed information consult http://www.transparency.org/global_priorities/education/corruption_education.

[13] For more details on this case, see Poder Ciudadano (2004).

Second, a public discussion of the text book selection criteria (terms of reference) and of the bidding documents (procurement process design) was arranged. This knowledge was introduced by providing all bidders with access to the draft bidding documents and by facilitating their discussion within a workshop. Although the results of the discussion were not mandatory for the Ministry, all suggestions for changes were accepted and introduced.

Third, rules to manage conflict of interest among the selection committee members were established. This included both a mechanism to identify potential conflicts of interest, and conflict of interest management guidelines. The identification mechanism consisted of a sworn declaration by the committee member that included: research and academic history, teaching experience, positions held in public agencies and private businesses, publications, relationships with publishing companies (work, ownership, etc.) and the sources of copyright royalties. These declarations were made public on TI's website. This allowed any participant to indicate the existence of a conflict of interest in a selection committee member, and the Ministry to implement the rules and exclude members that did not qualify.

In terms of the process design, some important elements stand out from this case:

- The existence of a pre-qualification stage designed to introduce competition into an otherwise non-competitive bid.
- The bidding process, because of the nature of the goods to be procured, does not focus only on prices but mainly on quality determined by the contents of the text and their pedagogical strengths. This was performed during the pre-qualification

process and was undertaken by the award committee.

- The introduction of transparency measures at various levels through:
  - The intervention of a third party and independent actor (TI Argentina) with a specific facilitator role.
  - The agreement on the ground rules included in the Pact and in the guidelines for conflict of interest management.
  - The availability and access to information equally guaranteed for all participants and the public and in all relevant aspects of the process (including conflict of interest situations).
  - The involvement of the participants in the process (workshop, discussion of terms of reference and conflicts of interest situation), and its ingredients: access to information, participation (open), transparency, process clarity.
  - The enforcement of the agreed rules (for example through the effective exclusion of committee members in conflict of interest situations).
  - The results of the process, as reported by the Chapter in Argentina[14] are as follows:
- 48 publishing companies participated in the process and signed the Integrity Pact.

Participating bidders presented in total 631 books, from which:

- 52 % were among those recommended by the committee.
- 20 % were not among those recommended by the committee.
- 28 % did not match the conditions established under the terms of reference.

The contract awards resulted in the following distribution:

- 48 % of the participating bidders had at least one book selected.
- The two publishing houses that had more books awarded each covered 15% of the total selection.

Only two bidders had only one book awarded, and 3 bidders had contract awards for 2 books.

[14] Ibid.

**The bid evaluation** is one of the most difficult phases to be carried out correctly and fairly, and constitutes one of the most vulnerable steps within the procurement process. It is one of the easiest steps to manipulate if someone wants to tilt an award in the direction of a favoured supplier or contractor: Evaluators can reject unwanted bids on trivial procedural grounds - an erasure, failure to initial a page - or for deviations from specifications that they decide are significant. After bids are examined, if no one prevents them, evaluators may discover/ invent entirely new considerations that should be taken into account in choosing the winner. Or the bid evaluation criteria may be so subjective and so lacking in objective qualitative elements that the evaluators' scoring can produce any result they wish. All of this argues for requiring bid **evaluation criteria** to be spelled out clearly in bid documents and for an impartial review authority to check the reasonableness of the evaluators' actions. The **results of the evaluation** including the major **elements of the evaluation and decision making process** should be publicly disclosed, too. Disclosing the criteria allows bidders to raise objections in advance if they consider the criteria not to be appropriate, and disclosure of the results and the reasons for them provides additional assurance that the evaluation has been conducted properly.

World Bank *"Red Flag"* indicators of potential manipulation/corruption during this stage[15]:

- "Bid evaluation committee members do not have the technical expertise necessary" to properly evaluate bids;
- "The bidding process is controlled by a small number of persons" in the Project Management Unit / Project Implementation Unit (PMU/PIU);
- "Qualified bidders drop out voluntarily as the bidding process progresses such that only one firm is left in the post-qualification stage";
- "Unreasonable delays in evaluating the bids and selecting the winner";
- "High number of complaints about bid process and evaluation received from losing bidders, especially when lower bids are declared non-responsive";

- Information necessary to evaluate the procurement process is missing;
- Only photocopied documents are available for review;
- Incorrect method of procurement noted during review (e.g. single-source instead of Competitive Bidding);
- Evaluation criteria are amended after receipt of bids;
- Same bidders repeatedly participating in similar types of contracts;
- "Same bidder repeatedly winning similar types of contracts";
- A narrow variance between the estimate and the bid amounts received;
- "Similarities between competing bids (e.g. format of bid, identical or nearly identical unit prices, identical (mis)spelling, grammatical and/or arithmetic errors, photocopied documents)";
- Bid bonds are acquired by competing bidders from the same financial institution;
- Bid bonds have similar date and/or have sequential serial numbers;
- "A bidder lists multiple addresses";
- "Unit prices in competing bids vary inconsistently by amounts greater than 100%;
- Unit prices in competing bids are identical";
- "Bidders propose identical items (e.g. the same make and model)";
- Common ownership in the bids of competing bidders;
- "The Bid Evaluation Report has been revised or re-issued";
- The Bid Evaluation Report has been performed in an unrealistically short time;
- "An arithmetic check of the bid(s) is not performed or results in a bidder being favoured inappropriately";
- "An evaluated bidder should have been disqualified based on the information submitted in their bid";
- "The lowest bidder is disqualified and the explanation, if any, provided is weak";

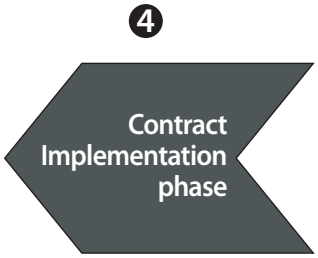
[15] Ibid Inspired by

- Seeking clarification is used as a cloak for financial negotiations:
- Vested interests or conflict of interest are identified among members of bid evaluation committee;
- "Falsification of curricula vitae in consultant services proposals";
- "Unreasonable delays in negotiating and executing the contract";
- "Contract is not in conformity with bid documents (e.g. specification and quantities)";
- "Contractor's name differs between Contract and Bid Evaluation Report";
- Contract amount is different from amount in Bid Evaluation Report;
- "Contract includes allowances for variations which are not part of the bidding documents";
- "Subcontracting requirements are imposed";
- "Rigorous system for handling contract variations and evaluating claims is not defined in the contract";
- "Staff involved in contract award decisions becomes involved in contract supervision".

**Things to Do During the Bid Evaluation and Award:**

- Bid evaluation criteria should be clear and determined from the outset, and should be made public;
- Ideally, different people should make the bid evaluation and the award decision;
- The award decision should be made by a group of people and not a single individual;
- The evaluation process and the award decision should be publicly available;
- Pro-active disclosure by government agencies of relevant information via website and other means, and openness to requests for information from the public; and
- Regular **staff rotation**, i.e. no officer or staff may remain in a position long enough to develop improper connections with, or dependencies on, potential bribers.

## The Contract Implementation Phase




It is important to note that this phase is just as vulnerable to corruption as the previous phases. Typical **examples** can be found in the engineering and construction sector: A bidder may have come to an understanding with a corrupt government official that the physical/technical controls on project execution would "not notice (disregard) sub-specification execution", meaning that the use of low-quality cement or the use of less reinforcement steel or the construction of a wall of 5 or 7cm rather than the specified 10 cm thickness would go through unchallenged. (Since this obviously saves significant amounts of money, the agreement might have even enabled the contractor to bid a very low price and thereby win the award.)

Another example is that the corrupt official would approve frequent price increases, usually in small incremental steps, each of which small enough not to require higher level approval. Or the corrupt official would approve other variation (change) orders under which the corrupt contractor would obtain additional work contracts at high, uncompetitive prices. Such wrongdoing can be avoided by stricter, more frequent and unannounced **controls** or, for example, by **external monitoring** by civil society (see below 3.4.. for CS monitoring as a tool). Another proven safeguard is the rule that, once the cumulative variation orders exceed a certain threshold, e.g. of 15% of the original contract value, for any additional price or other variation orders, no matter how small, **approval** must be sought from senior level managers.

World Bank "Red Flags"
or potential manipulation indicators during contract implementation phase[16]:

- Contract specifications or scope of work altered after contract awarded;
- Site inspection indicates that work performed was not in

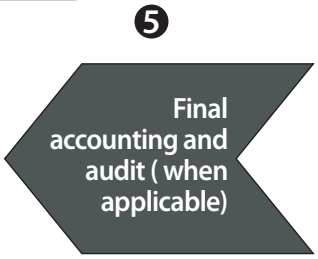
[16] Material directly quoted from or inspired by World Bank. See above.

accordance with the technical specifications (below-specification civil works, goods and services are accepted);
- Technical specifications of materials provided do not correspond to the specifications agreed upon in the contract;
- Site inspection indicates that project completion is less than that certified or that a completed project is not operational;
- Goods or services not being used, or being used for purposes inconsistent with intended purposes;
- Wrong quantities of goods and materials being delivered;
- Delays in the delivery of goods or services in any part of the project implementation process;
- Replacement of nominated consultant staff by less qualified and inexperienced personnel;
- Frequent changes in key staff of PMU/PIU;
- Changes in PIU/PMU and Bank staff responsible for post-procurement verifications;
- Lack, or low level, of oversight of the physical works;
- Absence of or insufficient post-procurement verification of scope of work and physical inspections;
- Site diaries and meeting minutes are not maintained;
- Instructions are not given in writing to contractors;
- Incomplete records in PIU/PMU – significant number of missing documents
- High frequency of Change Orders to the contract";
- As-built' drawings are photocopies of technical specifications in the bidding documents;
- The detailed drawings, 'as-built' drawings, back-up data sheets contain errors or repetitive entries;
- Failure to pay progress payments and invoices on a timely basis;
- Excessive number of signatures required to approve progress payments;
- Evaluation of contractors' performance not recorded;
- Cost overruns are inadequately explained or justified;
- Customer/Client dissatisfaction with completed facilities.

**Things to Do During the Contract Implementation:**

- Set up an independent monitoring system that will check contract implementation as for compliance with agreed specifications including quality. Random on-site checks prove to be an effective tool; and
- Have clear and pre-established limits for contract change orders. Many procurement laws have them incorporated and they can also be incorporated in the contract without the need of a law.

## The Final Accounting and Final Audit Phase




It is most important that the final **accounting** of a project be carried out by staff who has not been involved in any of the previous phases, so as to avoid any collusion or cover-up of previous wrongdoing during the final accounting phase.

An important safeguard, existing in most countries, is the final external **audit** of an investment. But unlike the usual procedure, under which the audit simply reviews and checks whether the numbers add up, the government should - at least for major investment projects - conduct performance audits which will also review the original cost estimate and benefit projections, compare them with the actual final cost of the project and the actual benefits (e.g. projected vs. actual traffic counts etc.), and assess whether the original justification of the project proposal still holds. If major discrepancies are discovered in the process, the reasons and the responsible officials should be investigated and held accountable.

Whenever controls or audits demonstrate or suggest that a contractor, supplier or consultant has possibly committed any acts of corruption, the case should be fully **investigated** by the prosecution authorities. If a crime is confirmed, the contractor / supplier / consultant should be held **accountable** – by claiming an adequate amount of damages and by debarring the person or company from participation in future bidding processes.

Red Flags or indicators of potential manipulation are the following:[17]

- No control system in place, inadequate or unreliable controls;
- No or inadequate parliamentary control and oversight in force;
- No follow-up to indications, suspicion or accusations of corruption;
- Lack of state or public interest in identifiable or anonymous accusations of corruption and no follow-up;
- Denying the public or legitimate civil society representatives access to documents and information held by the control and audit institutions, and to their proceedings;
- Lack of encouragement for whistleblowers;
- Lack of whistleblower protection system and procedure;
- Lack of audit requirements and system, much delayed audit or superficial/inconsequential audit;
- Inadequate or delayed publication of the audit report; and
- Lack of impact of a critical audit report (absence of (re-)action e.g. by the legislature, the country's Court of Audit, the judicial authorities and/or the administration).

## 2.2. ANTI-CORRUPTION STRATEGIES AND INITIATIVES OF PUBLIC AUTHORITIES

### *2.2.1. GOOD PROCUREMENT PRINCIPLES*

The application of the principles of integrity, transparency, accountability, fairness and efficiency to all decision making on public investments and purchases will minimise corruption and maximise the economic, financial, social, environmental and political benefits of public procurement.

#### Integrity

Integrity means that the procurement processes are honest and in compliance with the respective laws, that the best available, most suitable technical expertise is employed in a non-discriminatory manner, that fair and open competition leads to a quality product at a fair price (value for money), and that the product takes into account the legitimate aspirations and concerns of all the stakeholders.

## Transparency

Transparency means that laws, regulations, institutions, processes, plans and decisions are made **accessible to the public** at large or at least to "representatives" of the public so that processes and decisions can be monitored, reviewed, commented upon and influenced by the stakeholders, and decision makers can be held accountable for them. Corruption thrives in the dark and manipulation for personal benefit is facilitated by opacity. It is essential that transparency be created from the very beginning so that potentially every step in the long decision-making process can be viewed and influenced in a timely manner. Transparency needs to pervade all steps in the procurement cycle, from the earliest decision making by the respective authority about a new purchase or investment throughout the entire process of preparing the "project" economically and technically, the selection of the consultants, suppliers or contractors, the awarding and execution of the contracts and the final accounting and auditing phase.

Transparency in this context is not achieved by grudgingly allowing access to some internal documents to selected people. Transparency requires that the government or project agency (the "principal") voluntarily and proactively provide full public information through the print and electronic **media** about the potential options, plans, designs and programmes. Transparency also means that all the **stakeholders** of a major investment are fully informed and consulted about all aspects of the project. For example, on large dam projects it is essential that the affected population (those affected by potential resettlement as well as by upstream and downstream changes in the water flow regime) at large be allowed and indeed encouraged to participate in the process. It may be necessary to reach out directly to them through visiting teams. Experience of a few countries demonstrates that a series of well-publicised open public hearings (see below Section 3.3) is a particularly effective means to spread information and to obtain the stakeholders' commitment, contributions and support for a large project, and to avoid misguided

[17] Wiehen; Michael. Avoiding Corruption in Privatisation - A Practical Guide.

decisions. The transparent process may appear time-consuming and costly at the outset, but it is irreplaceable and will, in fact, **save time as well as costs** in the longer run. Projects which were prepared in secrecy, or with severely limited information for the stakeholders, often eventually run into public resistance or turn out to be tainted by corruption and are then sometimes held up for years.

Some people argue that transparency is counterproductive as it facilitates collusion among firms and reduces competition by putting sensitive information out in the public domain. This view falls into the paradox of advocating for obscurity for a lesser good. Collusion agreements will take place, and even more so in situations where they can be hidden thanks to obscurity and lack of monitoring. It also overlooks that the necessary transparency and disclosure of information does not include proprietary or legally protected information, but information that can and should be accessible. Ultimately, transparency increases the likelihood that a corrupt agreement will be discovered and thus will play a deterring effect.

Another powerful instrument for achieving transparency is the **internet**. Despite some – unsubstantiated - claims that openness of certain procurement process information could undermine and erode the quality of the process, could put confidential business information at risk and could endanger the entire project, several countries (Chile, Colombia to some extent, Mexico and New Zealand among others) and major municipalities (e.g. Seoul, South Korea) have recently placed their entire procurement system - including procurement opportunities, bid documents, relevant laws and procedures, and results of the tenders - on the Internet and allow free access to everyone to that information. In Pakistan, the World Bank has recently decided to put bid evaluation reports and contract information on the Internet, as soon as the contract has been awarded. Increasingly, all interaction between the government administration and companies doing business with it as well as citizens in general will be handled through this medium. If everybody can check on a real-time basis which contracts are offered by the principal at a given time, under what conditions, who the competitors are and

what prices they offered, the opportunity for manipulation and thus the temptation to bribe is greatly reduced. Different kinds of such systems as well as their typical features are summarised in further detail below (see Section 2.8.).

### Accountability

Accountability means that governments, public (government-owned or –controlled) institutions or corporations and individual officials, on the one hand, and companies, company executives and agents or other individuals acting on behalf of companies, on the other hand, must be accountable for the correct and complete execution of their tasks and duties and for the decisions and actions being made in their area of responsibility. Procedures enabling full accountability should be systematic and dependable.

Records explaining and justifying all decisions and actions should be created and maintained. Wherever violations of legal or contractual obligations occur, the perpetrator must be taken to task - by disciplinary, contractual, civil and/or criminal sanctions, as appropriate. Laxness in enforcing accountability will quickly erode integrity. The parties called to action in this context include governments, public institutions and officials, national or international financial institutions, "contractors" in the widest sense (i.e. private companies or individuals, governments or public institutions acting as contractors offering the supply of goods, contracting, consultancy or other services), stakeholders and also Civil Society organisations.

### Fairness, Economy, and Efficiency

Contract award decisions should be **fair and impartial**. Public funds should not be used to provide favours to specific individuals or companies; standards and specifications must be non-discriminatory; suppliers and contractors should be selected on the basis of their qualifications and the merit of their offers; there should be equal treatment of all in terms of deadlines, confidentiality, and so on. Procurement should be **economical**. It should result in the best quality of goods and services for the price paid, or the lowest price for the acceptable, stipulated quality of goods and services; not

necessarily the lowest priced goods available; and not necessarily the absolutely best quality available, but the best combination to meet the particular needs, and the published specifications. The procurement process should be **efficient**. The procurement rules should reflect the value and complexity of the items to be procured: Procedures for small value purchases should be simple and fast - though not at the expense of integrity, fairness or transparency - but as contract values and complexity increase, more time and more complex rules will be required to ensure that principles are observed. Decision-making for larger contracts may require complex committee and review processes. However, bureaucratic interventions should be kept to a minimum.

### *2.2.2. GOOD PROCUREMENT LAW*

The best procurement law is the one that is effectively applied. Due to globalisation, trade agreements, conditionality and other forces, increasingly procurement laws across the globe are becoming more similar. For example, many of these laws establish open bidding as the norm and restricted bidding, short listing or direct contracting as the exception. In many jurisdictions, however, open bidding is in fact not the norm, and exceptions to open bidding are often abused.

In fact, a study performed by TI on procurement systems in nine countries[18] revealed that corruption risk associated with the laws (bad quality, lack of appropriate transparency mechanisms, etc) was significantly lower (close to 35%) than the risk associated with how the laws actually are implemented (the risk was close to 65%).

It is therefore of little use to seek a universal model to adopt for a particular country. In looking for international standards, however, often the World Bank Procurement Guidelines and the UNCITRAL model law are cited. TI has also set out a recommendation of what should be minimum standards for transparency in procurement.

## UNCITRAL and/or GPA as a Model?

The United Nations Commission on International Trade Law (UNCITRAL) in 1995 issued a Model Law on Procurement of Goods, Construction and Services. This Model Law contains most of the World Bank's procurement principles up to 1995 and intends to serve countries to evaluate and modernise their procurement laws and practices. Unfortunately, it suffers from the effort to reflect all eventualities and even includes options (e.g. competitive negotiation) that, in fact, conflict with accepted basic rules. But of course countries need not make use of this variety of options. Apart from that, the Model Law is a good start, but it should be modified by including the many changes of the World Bank Procurement Guidelines since its introduction in 1995.

The General Procurement Agreement of the WTO (GPA) of 1996 is a pluri-lateral agreement and is therefore only applicable between countries that have accepted and ratified the Agreement. It contains basic principles of procurement and rests on the principle of non-discrimination between companies from a given country and companies from foreign countries as well as between companies from different countries. The Agreement also requires "transparency" of procurement processes (which under the terms of the Agreement primarily means that tenders have to be publicised), objective and fair criteria and effective legal remedies. Since 1996 and the WTO summit in Seattle in 1999, the extent of the transparency requirements as well as potential limitations of preference rules are under discussion.

[18] For more detailed information on results and the methodology used, consult http://www.transparency.org/global_priorities/public_contracting/projects_public_contracting/pcms.

## TI'S MINIMUM STANDARDS FOR PUBLIC CONTRACTING

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; and
- 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; and
- 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.

### *2.2.3. LAW ENFORCEMENT*

#### Criminal Punishment in General - National Legal Structures

Most countries outlaw bribery and other forms of corruption and impose criminal sanctions. At issue are the evidential requirements/ hurdles, the level of sanctions, the statute of limitations and the societal and legal impact of convictions.

#### Criminal Liability of Legal Persons / Corporations vs. Administrative Fines

When individuals commit criminal acts, they frequently act in the interest of, or even at the direct behest of, companies. Experience shows that only if companies themselves can be held liable and accountable for such criminal acts, they will undertake measures to curb corruption and manage their staff accordingly. While in principle administrative fines could be made to have significant impact, they often are insignificant (primarily due to a fairly low ceiling on fines

and the limited moral impact of an administrative fine vs. a criminal conviction) and thus are not respected as effective sanctions. Accordingly, the OECD Convention and UNCAC call on their signatory states to impose "effective, proportionate and dissuasive criminal or non-criminal sanctions". Many of the major industrial countries have established the concept of criminal liability of legal persons or corporations. Other countries should be challenged to adopt the concept of criminal liability of legal persons or at least to make their administrative fines system so as to allow truly "effective, proportionate and dissuasive" sanctions. One means to come close to this is to allow the fine to be set at a level that exceeds the economic benefit to the corrupt company.

### Liability for Damages

Corruption during the procurement process can cause damage to the principal as well as to the other bidders who incurred significant costs in preparing their bids, and it is only fair that corrupt individuals and companies be held liable for that damage. Since the quantification of the level of damages is often difficult, a practice has developed to pre–determine damages by stipulating in contract documents that if ever damages were to be paid, the amount would be, for example, ten or fifteen percent of the contract value, unless either of the parties can provide evidence that the actual damage was higher or lower ("liquidated" or pre-determined damages).

### Forfeiture / Confiscation / Seizure of Illegal Gains / Profits

A very effective sanction is the forfeiture or confiscation of illegal gains or profit. Operators having obtained contracts through bribery or other forms of corruption can in this manner be made to return not only the actual "profit" portion of the contract payment, but the entire payment for the contract.

### Civil Liability and Disciplinary Sanctions

In most countries, civil servants and administrative employees in the public or private sectors can be subjected to civil liability claims (liability for damages etc) and/or to disciplinary actions.

### Debarment ("Blacklisting") of Corrupt Economic Operators

Debarring economic operators (individuals and companies) that have been found to be corrupt, from the participation in the competition for future public contracts has been proven to be a very effective sanction against corrupt business people. Operators registered on the debarment list are then sometimes published through the internet (e.g. in the case of the World Bank's debarment register). Consulting the Register and respecting the debarment decisions of other government offices should be mandatory and binding on all public offices awarding contracts. Many governments and institutions (like the European Commission) are experimenting with debarment. Several issues arise in this context:

- What is **the evidentiary requirement** for putting an operator in the register? A final conviction ("res judicata") clearly is the safest condition. However, in most jurisdictions there are very few criminal corruption cases and convictions often take many years before becoming "final", at which point registration clearly would have little or no impact any more. At the other extreme, it is evident that registration cannot be justified if there is mere suspicion but no adequate evidence. Operators of registers have been experimenting with the level of evidentiary evidence. The World Bank, the manager of the only truly effective debarment register, lists an economic operator if "it is more likely than not" that the crime was committed. A confession of one of the actors of corruption would be a strong piece of evidence, but so would be irrefutable evidence that is not convincingly denied by the company or person under suspicion;
- The register should be fully public or at least fully accessible to the **public**.
- The list should be **binding** on all public offices of a country about to let a contract.
- The debarment should be effective for a **specified period of time** reflecting the severity of the violation.
- The law establishing the register should also clearly establish the **conditions** under which the economic operator

would be **removed** from the register prior to the lapse of the established period. Such conditions could include termination of employment of the individuals responsible for the corrupt acts, paying damages to the government office that was bribed, and possibly to the competitor bidders, introducing company anti-corruption guidelines and policies and convincingly implementing such new system, etc.

- It needs to be established to what extent subsidiaries, parent companies or joint venture **partners** of the debarred company should and could be covered by the debarment.
- Debarment needs to be scrupulously **implemented** – until the debarred operator takes convincing action to demonstrate that new procedures are effectively in place.

### Control of Procurement Processes

It is essential that governments/contracting authorities establish adequate internal and external control mechanisms, including monitoring by civil society, to reduce corruption to the maximum extent. "Adequate" means sufficiently funded and staffed and equipped with sufficient powers and rights to control, check and investigate records, documents etc. both of government and the private bidders who participate in a public bidding process. Any suspicion of wrongdoing must be followed up immediately in the appropriate form so that corrupt operators or officials understand that their activities are likely to be discovered and that they will be sanctioned

## *2.2.4. INTERNATIONAL ANTI-CORRUPTION CONVENTIONS*

### OECD and UN Anti-Corruption Conventions

While domestic bribery and extortion in procurement has been outlawed in practically all countries, the bribery of foreign public officials to obtain or retain a contract was a criminal act only in the United States (under the Foreign Corrupt Practices Act of 1977) until the OECD "Convention on Combating Bribery of Foreign

Public Officials in International Business Transactions", signed by all 29 member states of the OECD and five additional states[19] in December 1997, came into effect on February 15, 1999. Under the **OECD Anti-Corruption Convention** the signatory states undertook to modify their national legislation so as to provide for (more or less) uniform criminal and administrative sanctions against people and companies committing certain acts of bribery against foreign officials in the context of international business transactions. The process of translating the Convention into national laws has been satisfactorily completed, under monitoring by a peer review system, and the process of monitoring the implementation of those laws by the signatory states, again under a peer review system, is underway. Some major OECD and EU member states (e.g. Germany) have extended their national criminal structures to include the bribery of private business partners in other countries, and some to include facilitation payments (as distinguished from bribes proper). In parallel with the Convention processing, many states also finally abolished the tax deductibility of bribe payments. The OECD Convention still contains several gaps (e.g. the private-to-private connection, the toleration of facilitation payments, and the bribery through subsidiaries). International efforts to modify the OECD Convention in those regards are being prepared.

The only global convention is the UN Convention against Corruption (**UNCAC**) that was opened for signature on 9 December 2003 in Merida/Mexico and came into force in December 2005, when the required number of signatory states (30) had ratified or acceded to it. The UN Convention contains provisions at the preventative-organisational and the repressive-penal level as well as concerning international cooperation. Some of the most significant provisions are, for example, the requirement to adopt broad penal provisions against political corruption (Art.15 and Art.2 UNCAC), recommendations with regard to liability of legal persons such as companies (Art.26 UNCAC), provisions for whistleblower protection (Art.32, 33 UNCAC) and a provision on compensation for damages (Art.35 UNCAC). In this respect, UNCAC covers a broader range of corrupt activities than the OECD Convention. On the other hand,

UNCAC does not yet contain a monitoring mechanism such as that of the OECD Convention. At the time of writing, many of the major industrial countries have not yet ratified UNCAC.

### Regional Conventions

In **Europe**, the most important regional anti-corruption conventions are the **Council of Europe** Criminal Law Convention on Corruption[20] and the Civil Law Convention on Corruption[21] that entered into force in 2002 and 2003 respectively. They cover broadly the same ground as the OECD and UN Conventions. Neither has so far been ratified by most major industrialised European countries. There is also the **EU-Anti-Corruption Law** of 1998 and the **EU-Frame Agreement** (2003/568/JI) dated July 22, 2003 of the Council of the European Union concerning the fight against corruption in the private sector.

The first regional convention aimed at combating corruption was the **Inter-American Convention against Corruption** (IACAC)[22], which was adopted in 1996 in Caracas, Venezuela. It criminalises active, passive and trans-national bribery, illicit enrichment, the improper use of classified or confidential information, the improper use of state property, using influence on public authorities for illicit personal gain and the diversion of property or assets. Signatory states are obliged to incorporate those provisions into their own judicial system.

The **African Union** adopted a Convention on Combating Corruption[23] on July 11, 2003 in Maputo, Mozambique. It covers a

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[19] Argentina, Brazil, Bulgaria, Chile, and Slovakia.

[20]For a full text of the Convention see the following link: http://conventions.coe.int/Treaty/EN/Treaties/Html/173.htm .

[21]For a full text of the Convention see the following link: http://conventions.coe.int/Treaty/en/Treaties/Html/174.htm .

[22]For a full text of the Convention see the following link: http://www.oas.org/juridico/english/Treaties/b-58.html . See also TI's Civil Society advocacy guide for conventions: http://www.transparency.org/global_priorities/international_conventions/projects_conventions/americas

[23]For full Convention text see following link: http://www.africa-union.org/root/AU/Documents/Treaties/Text/Convention%20on%20Combating%20Corruption.pdf .

range of criminal offences including bribery (domestic or foreign), diversion of property by public officials, trading in influence, illicit enrichment, money laundering and concealment of property. It calls for measures on prevention, criminalisation, regional cooperation, mutual legal assistance and recovery of assets. It covers both public sector and private sector corruption, both supply and demand side. It is unique in containing mandatory provisions with respect to private-to-private corruption and on transparency in political party funding. It has not yet attained the number of ratifications required for entry into force.

For Asia, the **ADB OECD Anti-Corruption Initiative for Asia-Pacific**[24] led, in December 2000, to the adoption, by the 27 countries of the Region, of the non-binding Anti-Corruption Action Plan for Asia and the Pacific. The Action Plan refers to three "pillars" of action, namely "developing effective and transparent systems for public service", "strengthening anti-bribery actions and promoting integrity in business operations" and "supporting active public involvement". The Action Plan builds on cooperation among governments, international financial institutions, civil society and the business community. It is notable that the Action Plan refers to the protection of whistleblowers and to the monitoring role of NGOs.

### *2.2.5. PREVENTION*

Efforts to prevent corruption in public procurement ought to be seen as the responsibility of both governments (employers) and bidders/contractors, as an essential element of risk management. Those efforts should comprise clear and transparent process rules as well as clear behavioural rules for those involved:

#### Clear and Transparent Process Rules

- On the principal's side there should be clear procurement rules, based on the primacy of selection based on a competitive procedure, principally open competition; any other procedures should be an exception and require justification

(that is documented for later review);

- The "four-eyes-principle" and regular rotation of officials in sensitive jobs are just two of many proven preventive administrative measures. They should be widely applied;
- Administrative processes and decisions should be characterised by **compliance with rules**, not by broad discretion of officials; wherever officials have discretion, corruption is invited;
- Important decisions should be made by **more than one official**, such as by committee; and
- **Functions** should be **separated** so as to assure that decisions about investment needs, preparation, contracting, implementation and final accounting are handled by different officials. Whenever people perform double or multiple functions, natural checks and balances are foreclosed.

### Clear Behavioural Rules

- Governments, government departments and government-owned corporations as well as private companies need **Codes of Conduct** which are prepared involving the entire staff, promoted and "lived" by top level staff, and explained to and accepted by staff at large;
- The Code of Conduct should be based on a commitment to integrity and ethical behaviour. Corruption must be a clear theme. There should be a clear prohibition of giving or accepting bribes and facilitation payments;
- Specific **Guidelines** need to address the giving and acceptance of gifts, entertainment and other favours, and should establish zero tolerance (preferably) or low thresholds, in the latter case also addressing the frequency allowed;
- Company Codes should address the issue of political donations, donations for charitable purposes and sponsoring of government functions;
- Nepotism (the favouring of relatives or friends in appointments or promotions) should be addressed and specifically prohibited;

[24] For further information see: http://www1.oecd.org/daf/ASIAcom/ActionPlan.htm#actionplan.

- Regular sensitisation / training / refresher **training** for all staff, against written acknowledgment and commitment, needs to be assured;
- There should be clear rules and processes for **sanctions** in case of violations; prompt investigation upon suspicion and sanctioning is essential;
- There should also be a **commitment** to transparent and comprehensive book-keeping and a prohibition of "off-the-books" accounts, both domestically and internationally;
- Governments and companies should carry out an analysis of **potential entry points** of corruption and develop adequate protective systems for the weak points; and
- Governments and companies should develop **corruption indicators** ("Red Flags") such as expensive lifestyle of an official not explained by official or known legitimate income, no vacations, indebtedness, avoidance of controls, absence of complaints where complaints would normally be expected, etc..

There exists a variety of proven tools to put corruption prevention strategies in place. Model Codes are available to businesses, such as TI/SAI's Business Principles or the International Chamber of Commerce's Guidelines "Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations" (see below Section 3). It is the responsibility of business associations to assist individual businesses in developing such codes of their own.

### *2.2.6. CONTROLS AND CONTROL STRUCTURES (INTERNAL AND EXTERNAL)*

Apart from prevention strategies, controls and control structures need to be in place on both sides, the principal and the bidder, in order to curb corruption in public procurement. Such control structures should ensure:

- Effective and reliable internal and external **controls**;
- Internal and external **audit** structures, adequately staffed and resourced;

- **Monitoring** by Civil Society (see Section 3.2.4. for CS monitoring as a tool); and
- Any suspicion of wrongdoing needs to be promptly **followed-up**.

### *2.2.7. INFORMATION GATHERING - WHISTLEBLOWING*

One of the main characteristics of corruption is that it happens in secrecy. Both giver and taker of bribes are criminals and have no interest to share their information with others. The people most likely to observe or know about corruption are office colleagues of the corrupt official or competing bidders. Most of them are reluctant for various reasons to approach the authorities inside or outside to lodge charges. Considering that whistleblowers are the most important source of information about corruption crimes, governments and companies should establish clear **whistleblower encouragement** and whistleblower **protection rules**. Principals and companies should also take seriously and consider anonymous information – taking into account the fact, that in many jurisdictions the whistleblower is in danger of being reprimanded or criticised by colleagues and superiors alike. In other words, unless effective whistleblower protection rules are in place, the authorities need to be prepared to act on anonymous information – which very often turns out to be reliable and solid.

Possible means for information gathering are:

- Appointing decentralised **Anti-Corruption** or **Ethics Officers** - available to insiders and outsiders;
- Establishing a **Central Anti-Corruption Office**;
- Establishing a **Hotline** telephone connection - also for anonymous information;
- Appointing an external **Ombudsman** – if the ombudsman is an attorney, information provided to him is privileged and thus protected, and whistleblowers are more likely to offer information; and
- Establishing an **Electronic Information Gathering System**

- German authorities, for example, have developed and are using an electronic system that allows and accepts anonymous reports but enables authorities to approach and communicate with the whistleblower - without being able to breach his anonymity - for follow-up questions which often make the difference between useless and useful information.

### 2.2.8. E-PROCUREMENT

In recent years, government authorities have more and more made use of the internet for public procurement processes. The main objective here is "better value for money" by fostering access, competition, impartiality and transparency and by allowing control by civil society. Some of the main features of effective e-procurement systems are summarised here:

There are different **kinds of systems** in place, e.g. offering:

- Information only (in Latin America: 13 of 17 studied systems);
- Information and Transaction (in Latin America: Mexico, Brazil, Chile; in the Philippines, the Government e-Procurement System GEPS);
- Comprehensive coverage federal / state / municipal; or
- Partial coverage;
- Obligatory use (in Latin America: Brazil, Chile, Mexico, Peru, Venezuela); or
- Optional use.

E-procurement systems can **provide**:

- General procurement information on all government departments;
- Tender notices (goods sought, detailed specifications, etc.);
- Bidding documents;
- Minutes/records of bidders' conferences;
- Submission of bids;
- Bids received;
- Reports of award proceedings, e.g. who won and at what price;

in Chile even details on economic and technical evaluations and in Singapore details on the conditions of the winning bid are provided;
- Contract details;
- Comparison of prices paid by other buyers for same goods or services; and
- The payment process, i.e. electronic payment is possible.

Some systems also contain **reports** on:
- Statistics on buyers;
- Statistics on suppliers;
- Statistics on purchases by buyer and supplier; and
- Consolidated reports on all transactions (by region, by purchaser, by supplier or by other criteria, e.g. by official approving the award).

Among the **benefits** that have been observed with these systems are:
- Increased efficiency;
- Enhanced transparency;
- Pubic access (in Mexico universities, chambers of commerce, business; associations and NGOs are under contract to observe and monitor the processes);
- Better risk management;
- Higher levels of integrity and ethics;
- Significantly better access to government procurement for Small and Medium Size Enterprises (SMEs);
- Better access for non-local (provincial) bidders;
- Corruption avoidance;
- Cost savings (average 20%) compared to traditional procurement;
- In addition to federal government, other regional and municipal buyers join the system on a voluntary basis; and
- In Mexico the World Bank allows COMPRANET to supersede World Bank Procurement Guidelines.

Complaints and Appeals Systems are important for effective e-procurement.

Some **factors for success** that have been identified are:

- Unequivocal political will and support;
- Incremental introduction; and
- Extensive training for operators and suppliers.

Some typical **constraints** that have been identified are:

- Cultural barriers, e.g. getting SMEs to work with the Internet; and
- Resource constraints (financial and personnel).

## 2.3. ANTI-CORRUPTION INITIATIVES IN THE PRIVATE SECTOR

All stakeholders have a role to play in curbing corruption in public contracting. Together with efforts focused on improving government's performance and tools, work needs to be done together with the private sector in introducing practices that will help towards this aim. The main effort clearly focuses on what each company can do on its own, within its main area of responsibility and within its own industry. In addition, there are international and sector-wide private sector initiatives that we briefly outline here, without the intention of being exhaustive. While many of them do not relate exclusively to corruption in procurement, they present relevant initiatives with an impact in the field of procurement.

### *2.3.1. OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES[25]*

The OECD Guidelines for Multinational Enterprises contain recommendations for responsible corporate behaviour and standards of conduct that are based on voluntary commitment. Their aim is to increase the positive contribution of investments to the common welfare and to create an atmosphere of trust among

companies, employees, governments and the society as a whole. In this sense, these Guidelines are a comprehensive code of conduct for multinational enterprises to which the participating governments[26] have committed.

**The Guidelines:**

- Apply to business operations worldwide; they cover multinational enterprises in member countries irrespective of where those enterprises pursue their activities;
- Were developed by involving representatives of corporations, employees, and non-governmental organisations; and
- Are provided with an implementation mechanism (National Contact Points in each country as well as the OECD investment committee CIME).

The Guidelines comprise 10 chapters and address the following topics: disclosure, employment and industrial relations, environment, combating bribery, consumer interests, science and technology, competition and taxation. They go back to 1976 and their most recent revision took place in 2000, resulting in the following alterations:

- Integration of human rights and condemnation of child and forced labour;
- Integration of the principle of sustainability and strengthening of the chapter on environment;
- Introduction of a new chapter on consumer protection;
- Strengthening the fight against bribery and corruption;
- Acknowledgement of the particular role and needs of small and medium enterprises; and
- Improved implementation through revaluation of the National Contact Points established in all participating countries.

[26] See also on http://www.oecd.org/dataoecd/15/43/33914891.pdf .

[27] This includes the 30 OECD member countries and nine other countries, known as signatory countries: Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, Romania, and Slovenia.

For the implementation of the Guidelines, a National Contact Point has been established in each participating country. Their tasks comprise the publication and promotion of the guidelines, the handling of enquiries and the dealing with individual cases, usually on the basis of complaints by one of the involved. Among the involved are ministries, representatives of the industry, of trade unions and of selected non-governmental organisations such as Transparency International. All National Contact Points come together annually for an exchange of ideas.

### 2.3.2. UN GLOBAL COMPACT[27]

The initiative of the UN Secretary General Kofi Annan of a "Global Compact" between the United Nations and the corporate sector was first presented at the World Economic Forum in Davos in 1999. Its aim is to strengthen the cooperation between the UN, the corporate sector and other groups in society and to utilise this for the implementation of some of the UN's key targets. The Secretary General calls on corporations to adopt ten principles related to human rights protection, social and environmental standards, and anti-corruption that are derived from key UN targets, and to respect them on a voluntary basis in the management of their businesses. They derive from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the World Summit for Social Development in Copenhagen 1995, the Rio Declaration on Environment and Development of 1992 and the United Nations Convention Against Corruption. The 10th Principle "Anti-Corruption" was integrated after long debates in 2004.

The participating companies are expected to publish evidence of their commitment to the "Global Compact" from their business activities on the Global Compact's Internet website. This is meant, on the one hand, to provide other companies with inspiring examples and, on the other hand, to give non-governmental organisations and the wider public the opportunity to comment. Currently, more than

1,700 internationally operating companies take part in the Global Compact.

**The Global Compact Principles Are:**

**Human Rights**

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights;

Principle 2: Make sure that they are not complicit in human rights abuses;

**Labour Standards**

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: The elimination of all forms of forced and compulsory labour;

Principle 5: The effective abolition of child labour;

Principle 6: The elimination of discrimination in respect of employment and occupation;

**Environment**

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: Undertake initiatives to promote greater environmental responsibility;

Principle 9: Encourage the development and diffusion of environmentally friendly technologies; and

**Anti-Corruption**

Principle 10: Businesses should work against all forms of corruption, including extortion and bribery.

[27] See also the official Global Compact website: http://www.unglobalcompact.org/ .

### 2.3.3. FIDIC "POLICY STATEMENT ON BUSINESS INTEGRITY" OF CONSULTANTS

While in the past most efforts at cleaning up procurement processes have been directed at contractors and suppliers, it has more recently emerged that some consultants have contributed their share to the poisoning of the markets. Consultants may bribe in order to obtain a contract (they will give a bribe to obtain information from government officials, a larger bribe to be placed on the "short list" and a yet larger bribe to be selected), they may (with or without the connivance of the authority) introduce a bias into the design, the specifications and bidding documents in favour of a "close" contractor or supplier, and they may carry out their monitoring and supervisory tasks during project implementation with a bias, either in favour of a corrupt official or of a "close" contractor or supplier. The "closeness" to a particular contractor or supplier may be based on legal (contractual) relationships or on past business associations. Systematic efforts are therefore necessary to select an able, independent and incorruptible consultant.

FIDIC (Federation Internationale des Ingenieurs Conseils), the largest association of consultant engineers globally, therefore introduced, as early as 1996, an Ethics Statement and a specific Policy Statement on Corruption ("Policy Statement on Business Integrity"). It states, for example:

- Corrupt practices can potentially happen at all stages[28];
- The Consulting Firm must not accept remuneration from suppliers which are under consideration for incorporation into the design, and must avoid references to brand names;
- Qualification-based selection procedures and competitive tendering, respectively, should be used;
- Member firms should be aware of local laws regarding corruption and should promptly report criminal behaviour to the proper law enforcement authorities; and
- FIDIC Member Associations should take prompt disciplinary actions against any member firms found to have violated the FIDIC Code of Ethics[29].

In 2001, FIDIC launched an Integrity Programme, which is a welcome private sector initiative to prevent corruption in public procurement funded by International Financial Institutions (IFIs) such as the World Bank or the Regional Development Banks: FIDIC recommends to its members the development of a Code of Ethics as well as the participation in a new initiative of "commitment to integrity" by applying the FIDIC "Business Integrity Management System (BIMS)".[30]

### *2.3.4. CODES OF ETHICS IN BUSINESS*

#### International Chamber of Commerce – Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations[31]

The International Chamber of Commerce first published its Rules of Conduct in 1977 and revised them in 1996 and most recently in 2005. They address the main manifestations of corruption and provide companies with hands-on recommendations on how to prevent corruption:

- Nobody should, directly or indirectly, demand or accept bribes;
- No company should, directly or indirectly, give or offer bribes;
- Enterprises should not (i) kick back any portion of a contract payment to government officials or to employees of the other

[28] "Corrupt practices can occur at all stages of the procurement process: in the marketing of engineering services, during the design; in preparing tender documents (including specifications); in pre-qualifying bidders; in evaluating tenders; in supervising the performance of those carrying out the construction; issuing of payment certifications to contractors; and making decisions on contractors' claims." FIDIC Policy Statement on Corruption 1996.

[29] FIDIC Policy Statement 1996, Recommendation 5.

[30] The FIDIC policy statement can be found at: http://www1.fidic.org/about/statement16.asp
It contains links to the FIDIC "Business Integrity Management System (BIMS)" and the FIDIC Code of Ethics.

[31] http://www.iccwbo.org/policy/anticorruption/id870/index.html.

contracting party, or (ii) utilise intermediaries such as agents, subcontractors, consultants or other third parties, to channel payments to government officials, or to employees of the other contracting party, their relatives, friends or business associates;
- Any payment made to any agent should be no more than an appropriate remuneration for legitimate services rendered by such agent;
- No part of any such payment should be passed on by the agent as a bribe or otherwise in contravention of these Rules of Conduct;
- Companies should maintain a record of the names, terms of employment and payments to all agents who are retained by them in connection with transactions with public bodies, state or private enterprises;
- All financial transactions must be properly and fairly recorded in appropriate books of account available for inspection by boards of directors, if applicable, or a corresponding body, as well as auditors;
- There must be no "off the books" or secret accounts, nor may any documents be issued which do not properly and fairly record the transactions to which they relate;
- The Board of Directors' ultimate responsibility for an enterprise is confirmed; and
- Enterprises should implement comprehensive policies or codes reflecting the ICC Rules of Conduct.

In the 2005 revision several particularly crucial points were strengthened on the basis of recent experiences:

- Facilitation Payments (as opposed to bribes) are now also clearly stated as improper;
- Companies should offer confidential channels to raise concerns, seek advice or report violations without having to fear retaliation;
- "Bribery and extortion" have been defined even more broadly than previously, particularly with regard to permissions, licences, taxation and customs duties as well as judicial and legislative procedures;
- The precautionary recommendations regarding the use

of agents and other intermediaries are strengthened by the prohibition of bribes through foreign subsidiaries, joint venture partners and outsourcing agreements;
- Political and charitable contributions and sponsorships should not be used as a subterfuge for bribery; and
- The (very limited) allowance of gifts, hospitality or expenses has been limited and defined more clearly.

### The TI/SAI Business Principles for Countering Bribery (BPCB)

Transparency International, in co-operation with Social Accountability International, spearheaded the development of the Business Principles for Countering Bribery (BPCB), introduced in December 2002.

The Business Principles are the product of a cooperative effort of a Steering Committee drawn from companies, academia, trade unions and non-governmental bodies. The Business Principles provide a model for companies seeking to adopt a comprehensive anti-bribery programme. TI encourages companies to consider using the Business Principles as a starting point for developing their own anti-bribery programmes or as a benchmark for existing ones.

To support the users of the Business Principles, TI has produced a suite of tools, including a comprehensive Guidance Document which provides additional background and practical information for those wishing to implement the Business Principles or review their own anti-bribery processes. The TI Six Step Implementation Process is a how-to guide for companies that are early on in the process of devising and implementing an anti-bribery programme. TI is also developing a Self-Evaluation Module to assist companies wishing to assess their anti-bribery performance.[32]

[32] The Business Principles as well as the Guidance Document and a document outlining the Six Step Implementation Process can be downloaded for free from TI's homepage at: http://www.transparency.org/global_priorities/private_sector/business_principles .

### 2.3.5. AGENT'S CONTRACTS

Agents (or consultants, middlemen, contractors etc) often are providing perfectly legitimate services, but perhaps just as often they are used by businesses to carry out corrupt acts which the businesses themselves are reluctant to perform; this is especially true for agents etc in foreign countries. In order to prevent such corrupt practices, the company selecting such an agent etc should do the following:

- Carry out **due diligence** on the agent regarding the agent's integrity history;
- Execute a **written contract** in which the tasks to be performed are specified in detail;
- The **compensation** to be agreed should not exceed fair compensation for legitimate services actually performed;
- The compensation should be paid into a **named account** in the agent's country of residence and/or work; and
- The agent should be asked to sign a commitment that he would comply with the principal's **integrity** programme.

### 2.3.6. TI'S INITIATIVES WITH SPECIFIC SECTORS

Transparency International has started working with different sectors where corruption in public contracting is a particular problem. Among them are the construction and engineering sector, the water industry and the defence industry.

#### Construction and Engineering Industry

TI has an international initiative aimed at preventing corruption on construction projects which has been running for four years. This initiative involves:

- the development of reports advising on different aspects of corruption in the industry;
- the development of anti-corruption actions and tools specifically designed for the industry, and

- working with the industry, governments and civil society to try to address problems associated with corruption.

The reports that have been produced relate primarily to the risks of corruption for project owners, funders, and construction and engineering organisations, and to actions that may be taken by those parties to avoid corruption. There is also a report which provides detailed examples of corruption in the industry.

A number of anti-corruption tools, designed specifically for use in the construction and engineering sector, have been or are being developed. These tools include anti-corruption agreements, agreements for the appointment of independent assessors to monitor projects, anti-corruption rules for individuals, due diligence procedures and transparency requirements.

TI has been working closely with government, industry and civil society to develop anti-corruption measures. TI (UK) has been instrumental in the setting up and co-ordination of the UK Anti-Corruption Forum which is an alliance between business associations, professional institutions, organisations and companies with interests in the infrastructure, construction and engineering sectors. The UK Forum has issued an Anti-Corruption Action Statement which sets out the actions which need to be taken by the various participants in these sectors to prevent corruption. TI is promoting the development of similar forums in other countries.

Further information on this initiative, and copies of the anti-corruption reports, actions, and tools, can be obtained from the TI website: http://www.transparency.org/tools/contracting/construction_projects

**Water Industry**

The pervasiveness of corruption in the water sector spurred TI and seven leading water organisations (International Water and Sanitation Centre (IRC) of the Netherlands, IBON, an NGO located in the Philippines, the Stockholm International Water Institute (SIWI),

the Swedish Water House (SWH), the Water and Sanitation Program-Africa (WSP-Africa) of the World Bank, AquaFed (an International Federation of Private Water Operators) and UNICEF to found the Water Integrity Network (WIN) in early 2006.

With corruption estimated to be draining 20-40% of the water sector's financing, a successful anti-corruption strategy can be a significant factor in attacking some of the major problems in the water sector, including the lack of a sustainable supply of clean drinking water by a billion of the world's population; the lack of adequate sanitation by approximately 3 billion people; and the estimated 900 million people that suffer from hunger.

The WIN promotes solutions-oriented action and coalition-building among civil society, the public and private sectors, media and governments. The network's core work will include diagnosing the sources of problems in the water sector, proposing solutions, building capacity and monitoring progress. A fund for civil society activities in developing countries is also envisioned to help develop effective local anti-corruption coalitions.

One of the first tasks of the WIN will be to collaborate with TI in preparing the 2008 Global Corruption Report (GCR), which will focus on the water sector. This document will present the results of the latest research in identifying the causes of corruption in all aspects of the water sector including water supply and sanitation, irrigation and the hydropower sectors. In addition, it will present the best practice on how all the major actors (including Government, the private sector and civil society) can increase their effectiveness in combating corruption in the water sector. It is expected that the report will focus on corruption in northern and southern countries and will draw extensively on the experience of the TI chapters and other stakeholders in addressing corruption issues in the water sector.[33]

### Defence Industry

TI is also, through its National Chapter in the UK, leading a global project in the defence and security sector, working with the major

stakeholders – exporting governments, importing governments, companies and other organisations (NATO, EU, World Bank, and others) – to reduce corruption in the defence sector, and particularly in defence procurement. TI's global research shows that the arms and defence sector is one of the most corrupt private sectors.

Work with this sector consists of four main activities:

1. Working with defence companies to encourage the development of an industry consortium against corruption in international tenders;
2. Testing the use of a procurement anti-corruption tool, Defence Integrity Pacts (DIP), in major defence tenders. Integrity Pacts (IPs) are enforceable anti-bribery pledges overseen by an empowered independent monitor. DIPs lend added credibility to the procurement process through enhanced transparency and accountability and are being implemented already in several countries like India, South Korea, and Colombia;
3. Working to improve anti-corruption capability in defence ministries and in their procurement practices, aiming to develop good practices in this area; and
4. Working to strengthen laws and international instruments against bribery in defence related activities. This includes engagement in discussions on a EU Code of Conduct on arms export controls, engaging with the World Bank and other multilateral lenders to discuss ways to influence government defence reform, as well as being in touch with national Export Control organisations to discuss ways to strengthen anti-corruption measures in arms exports.[34]

[33] Please visit http://www.waterintegritynetwork.net/ for further information.

[34] More information can be found on TI's website: http://www.transparency.org/news_room/in_focus/2006/defence_sector .

## SECTION 3 COLLABORATIVE TOOLS (INVOLVING GOVERNMENTS, COMPANIES AND CIVIL SOCIETY) TO PREVENT OR REDUCE CORRUPTION.

There are tools, some of them developed by TI, that are based on a collaborative approach involving committed contracting agencies, companies and civil society. Below is an outline description of some of them[35].

It is now widely recognised that Civil Society can have a crucial role in contributing to the transparency and integrity of public procurement processes. There are a number of roles Civil Society can play in bringing transparency to procurement processes. Civil Society can play a key role in monitoring procurement processes, in being a source of expertise and an independent voice to raise issues and difficult questions, to manage conflict and balance powers and bring together groups of people.

### 3.1. THE TI INTEGRITY PACT

In order to assist countries, which are prepared to introduce transparency and integrity into their procurement and implementation process overall and wish to set a public precedent of their commitment, TI has developed the Integrity Pact (IP).

TI developed in the mid-1990's the concept of the Integrity Pact (IP), originally called the "Islands of Integrity" concept. The IP contains rights and obligations to the effect that neither side will pay, offer, demand or accept bribes of any sort, or collude with competitors to obtain the contract, or while carrying it out. Also, that bidders will disclose all commissions and similar expenses paid by them to anybody in connection with the contract; and that sanctions will apply when violations occur. These sanctions range from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to debarment for future contracts on the side of the bidders, and criminal or disciplinary action against employees of the government.

Many companies and government officials would rather not get involved in corruption. The IP allows companies to refrain from bribing in the knowledge that their competitors are bound by the same rules and the assurance that the government agency will not request them either. The IP allows governments to reduce the high cost of corruption on procurement, privatisation and licensing. The IP has shown itself to be adaptable to many legal settings and flexible in its application. Since its original conception, the TI-developed tool of the Integrity Pact has now been used in more than 14 countries worldwide and has benefited from the feedback of a variety of individuals and organisations.

The IP has been conceived to be applied to individual and specific contracting processes, therefore their goals remain initially restricted to provide transparency and prevent corruption in that particular contracting process. In some circumstances, however, IPs have contributed to changes beyond those specific instances or have triggered wider change processes. Beyond the individual impact on the contracting process in question, the IP and its consequences within contracting systems are also intended to create confidence and trust in the public decision-making, a more hospitable investment climate and public support for the government's own procurement, privatisation and licensing programmes.

The main elements of this concept are:

- A pact (**contract**) among a government office (inviting contractors or suppliers to submit tenders for a public sector project – the „principal") and those companies submitting a tender for this specific project (the „bidders");
- An undertaking by the principal that its officials will **not demand or accept any bribes**, gifts or payments of any kind etc, with appropriate disciplinary, civil or criminal sanctions in case of violation;
- A statement by each bidder that he has **not paid, and will not pay, any bribes** "in order to obtain or retain this contract" (thus

[35] More detailed information is available on the TI website: http://www.transparency.org . The TI website also has new materials regarding Integrity Pacts and anti-corruption in public contracting.

excluding facilitation payments; although TI makes it clear, that it recommends to all to forego facilitation payments as well);

- An undertaking by each bidder to **disclose all payments** made in connection with the contract in question to anybody (including agents and other middle men as well as family members etc of officials);
- The explicit acceptance by each bidder that the no-bribery commitment and the disclosure obligation as well as the attendant sanctions remain in force, for the winning bidder, **until the contract has been fully executed**;
- Undertakings **on behalf** of a bidding company will be made "in the name and on behalf of the company's Chief Executive Officer";
- Bidders are advised to have a company **Code of Conduct** (that clearly rejects the use of bribes and other unethical behaviour) and a Compliance Programme for the implementation of the Code of Conduct throughout the company;
- A pre-announced **set of sanctions** for any violation, by a bidder, of its statements or undertakings, including (some or all)
  - Denial or loss of contract,
  - Forfeiture of the bid or performance bond/security,
  - Liability for damages to the principal and the competing bidders (preferably through pre-determined or "liquidated" damages),
  - Debarment of the violator by the principal for an appropriate period of time; and
- Adjudication of any conflict between the parties to the IP can be by arbitration, if the IP so stipulates; the applicable law and the process of selecting the arbitrators would also be stipulated in advance.

The IP establishes contractual rights and obligations of all the parties to a procurement process and thus **eliminates uncertainties** as to the quality, applicability and enforcement of criminal and civil legal provisions in a given country. This means that applying the IP concept can be done **anywhere** without the normally lengthy process of changing the local laws. Where local laws adequately regulate some aspects of the IP, the IP

may refer to those laws.

The IP is intended to accomplish **two primary objectives**:

1. to enable companies to abstain from bribing by providing assurances to them that
   - their competitors will also refrain from bribing,
   - government procurement agencies will undertake to prevent corruption, including extortion, by their officials and to follow transparent procedures; and
2. to enable governments to reduce the high cost and the "distortionary" impact of corruption on public procurement.

Beyond the individual contract in question, the IP is also intended to create **confidence and trust** in the public decision making process in general, a **more hospitable investment climate** and public support – in-country – for the government's procurement, licensing and privatisation programmes.

From the outset it has been expected that Civil Society in the respective country would play a key role in overseeing and monitoring the correct and full implementation of the IP. This monitoring function can be carried out by a civil society organization (provided it has the required capacity) or by a competent individual(s) selected by civil society.

The IP concept is **suitable** not just for construction, supply and other procurement contracts, but equally for other contracting processes such as:

- selection of (engineering, architectural or other) **consultants**,
- Selection of the buyer/recipient of state property as part of a government's state asset **privatisation** programme, or
- Selection of the beneficiary of a state **permit, license, or concession** (such as for oil or gas exploration or production, mining, fishing, logging or other extraction rights), or for government-regulated services (such as telecommunications, water supply or garbage collection services).

Since an IP includes a sanctions mechanism, the question – just as with regard to the requirements for debarment/blacklisting (see above

Section 2.2.) – very often asked is "what kind of **evidence** is required to be certain of a violation by a bidder" so as to trigger sanctions? Just as with the requirements for debarment, the practice is emerging of considering it as adequate evidence of a violation if "on the basis of the facts available (admission of guilt, witness statements or documents) there are no material doubts" or "it is more likely than not" that the violation has occurred. The judgment would be made by the office triggering the sanctions in collaboration with the prosecution or judicial authorities or by the arbitrator when such mechanism has been agreed for conflict resolution and enforcement of the Pact.

The Integrity Pact is being applied or tested in a growing number of countries. The concept of a contractual arrangement appeals to many governments, but also to corporations acting globally.

**Integrity Pact in Colombia.**
**Telecommunications Sector.**

The Colombian Chapter of Transparency International (Transparencia por Colombia) has implemented more than 60 Integrity Pacts in a wide variety of sectors. Here we will focus on one of the cases in the Telecommunications sector.

An Integrity Pact was implemented within a bidding process called "Compartel", a rural communications project that aimed at providing access to telephone services in poor and distant rural areas.[36] In particular, we focus on one specific instance within this project called Compartel I. This bid took place in 1999 to contract the operators and suppliers of 6500 public telephone access points.

The telecommunications market in Colombia was opened for private investment in 1993, allowing foreign investors to have equal treatment as the national investors. Telecom, the then state-owned monopolist provider of long distance telecommunications service and the project Compartel sought specifically to open competition and investment opportunities to the rural and distant area's market.

The goals of the IP as spelled out by the Chapter were:

- To increase the transparency of public bids, generating trust

and credibility on all stakeholders;

- To create a voluntary cultural change among participants, aimed at facilitating that their behaviour be close to ethical standards and the legal standards spelled out in Colombian law;
- To agree on rules of the game contributing to levelling the playing field between the contractor and the public agency; and
- To produce information on the corruption risks map identifying vulnerabilities, common and special elements among different bidding processes.
- The Ministry of Communications invited TI Colombia to implement an Integrity Pact in the Compartel project when the terms of reference were ready for the Compartel I process. Therefore in this case the process could not start with a participatory discussion of the terms of reference. However, the Chapter with the support of experts revised and commented upon those terms as a precondition to participate in the process.

The process included: 1) the discussion and signature of a voluntary Integrity Pact. The Pact included the disclosure by the winner, under a confidentiality agreement, of all payments made to third parties on the occasion of the contracting process. 2) The implementation of an ethics declaration signed by the officials and advisors from the Ministry involved in the process. This declaration included a range of prohibitions that public officials should follow, regulating possible current and future conflicts of interest.

In the case of Compartel I, all bidders signed the Pact. In terms of the process design three aspects especially stand out:

1. The intervention of a third independent party (TI Colombia) playing a role of facilitator of the introduction of transparency measures in the process, including experts to provide input on

[36] For a complete report, consult: http://www.transparenciacolombia.org.co. We have selected here one of those cases and therefore this does not reflect the whole of the experience.

substantial aspects of it.;

2. The discussion promoted by TI around the Integrity Pact, its process and consequences. This enabled the participants to talk about the risks in the process and take explicit steps against them. For example, the ethics declaration signed by the officials contained explicit measures that guarded them from situations that would concern how they handle the information on the process; and[37]
3. The role played by the Colombian Chapter in introducing transparency to the process of clarification of bid requirements, requesting and supporting their publication.

In all other aspects the process continued as foreseen and originally designed. Once the contract was awarded there were no allegations from any of the participants on violations of the Pact or any acts of corruption. The then monopolist participated competitively in the bids and in one case was disqualified for presenting a bid without matching the bid terms.

When interviewing bidders who lost[38] they underscored the role that the IP process played in encouraging them to participate in the bids. In one case the bidder specifically expressed that to be their first time to participate in a public contracting bid and that the IP helped them ease some of the concerns they had to enter the market.

In the telecommunications sector there are only few competitors (even at the international level); therefore the inclination to collude may be higher than in other sectors. This also makes corruption prevention efforts more difficult as the costs and risks of whistle blowing are higher. This means that other measures to prevent corruption need to be in place. The Integrity Pact itself provides mechanisms to enforce sanctions in case of breach, and the disclosure of payments made by the winner of the contract to agents and others also increases the hurdle of corruption. In this specific case, however, there have been no signs of collusion or allegations of it.

**Social Witness as Monitoring Tools.**
**The Integrity Pact as Applied in Mexico.**

Transparencia Mexicana, TI's National Chapter in Mexico, has implemented more than 45 Integrity Pacts introducing a "social witness" as the monitoring system. The case of "El Cajón" hydroelectric plant can help illustrate its operation.

## El Cajón

The use of the Integrity Pact encompassed the bidding process for various engineering works on the 1,228 GWh hydroelectricity plant, known as "El Cajón". The project was billed as Mexico's most important infrastructure project of the decade. It was the first time the federal government, via the Federal Electricity Commission, had accepted independent monitoring by a civil society organisation of a bidding process in the energy sector. The case had particularly high expectations, given the size of the project and the sector's reputation as being tainted by high levels of corruption.

The particular elements of this IP were the following:

- Designation of a "Social Witness" (Testigo Social) as an independent and technically competent monitor;
- Unilateral Integrity Declarations by the bidders;
- Integrity Declarations by public officials;
- Meeting of TI Mexico with each of the bidders;
- Monitoring of the bid evaluation; and
- Final report produced by the Social Witness.

The Social Witness represented Transparencia Mexicana. He acted as a spokesperson and monitored all stages of the procurement process. The bidders were required to submit Unilateral Declarations, signed

[37] This meant both confidential information and information that legitimately would concern other bidders.
[38] Interviews performed by Juanita Olaya during 2001 for TI.

by the highest-level officials of the bidding consortia, to Transparencia Mexicana as a condition for competing for the contract. Declarations were also submitted by CFE officials and by all government officials involved directly in the contracting process.

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. Companies were evaluated on technical and economic grounds. The technical test was whether they complied with the qualifying criteria; the economic test was to determine the lowest bid. The Social Witness produced a final report that was made public.

In all, 31 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 bids. The contract was offered to the consortium that had requested US $748 million for it, which was below the government's allocated budget for the project.

## The Social Witness

The Social Witness must fulfil the following requisites: 1) High reputation and public trust, 2) Expertise on the particular area subject to its monitoring, 3) Must be absolutely independent from any of the parties participating to the Integrity Pact and the contracting process he or she will monitor, in order to avoid any possible conflict of interest.

A specially designated team provides support to the Social Witness in performing his/her duties. He or she should have full access to all process information and perform at a minimum the following activities:

- Reviews the terms of reference and other basic bidding documents, including the invitation to participate;
- Takes part in all meetings that take place with the potential or current bidders;
- Receives the unilateral integrity declaration from the bidders;
- Serves as witness to the presentation of bids and also during the

session in which the award decision is communicated;
- Prepares a final report that is publicly available; and
- Is entitled to communicate, through the media, the development of the process, including both negative and positive aspects.

The Social Witness is "integrated" into the contracting process via a collaboration agreement signed by the contracting agency (the principal). The costs of operation of the monitoring system are covered (i) 50% by all participating bidders and (ii) the remaining 50% by the selected winner.[39]

## 3.2. THE INTEGRITY CLAUSE

Short of applying the full Integrity Pact, principals may insert so-called Integrity Clauses in their contracts with suppliers, contractors and consultants. Such clauses normally stipulate that the supplier etc (i) **has not** been convicted, and has not been formally investigated, of a corruption crime and (ii) has not and **will not** resort to bribery or any other form of corruption in the context of the respective contract. Misinformation by the supplier under such clause would give the principal the right to cancel the contract unconditionally. Some major public institutions that enter into many purchase, construction and consultancy contracts, elect to insert such a clause into their General Purchasing Rules that are then incorporated into individual contracts by reference. A setback of the Integrity Clause is that it normally contains no direct sanction. Another limitation is that the Clause in the absence of an independent monitoring system might be ineffective.

[39] For additional information, please contact:Transparencia Mexicana. Mónica Gabriela Ramírez. Dulce Olivia 73, Colonia Villa Coyoacán, México, DF, 04000. México Phone/Fax: +52-55-5659 4714 E-mail: transparencia99@Prodigy.net.mx, or see: http://www.transparenciamexicana.org.mx/pactosdeintegridad/#pactos .

## 3.3. PUBLIC HEARINGS

Experience of a few countries demonstrates that a series of well-publicised open public hearings is a particularly effective means to spread information and to obtain the stakeholders' **commitment, contributions and support** for a large investment project, and to avoid misguided decisions possibly reflecting manipulative influence of corrupt politicians, consultants, suppliers or contractors. For the construction of a new subway line in Buenos Aires, for example, three large public hearings were held at which the Mayor of Buenos Aires himself laid out the plans and invited comments and suggestions e.g. on the situation of the line, the location and design of the stations, the process for selecting the construction companies etc. The hearings were broadcast live on local TV and were video-recorded for later reference, and were a huge success.

**Waste Collection Services in the Municipality of Moron, Argentina. Public Hearings for Contract Renegotiation**

In March 2000, the municipal government of Morón and Poder Ciudadano (Transparency International's Chapter in Argentina) had signed an agreement of co-operation to implement the "Programme for Transparent Contracting", for the municipal waste collection services. Morón is a municipality of 355,000 inhabitants, located in the centre of Buenos Aires Metropolitan Area, one of the main urban centres of the region. One of the most important management issues in Morón was the contracting of a waste collection service for the city. The waste collection contract had a value of US$ 32 million per annum, or 10% of the city's budget, and was to last a minimum of four years. It was awarded in the year 2000 to a Spanish company. In 2003, three years after the contract was awarded, the cost structure of the contract had to be renegotiated. Poder Ciudadano designed a process to introduce transparency to this renegotiation by using public hearings.

The approach included participation of Poder Ciudadano in the Public Hearings as independent observer, facilitator and monitor. It also included the disclosure of the renegotiation deliberations by presenting publicly a report on the outcome of the Public Hearings.

Around 150 people consisting of neighbours, public officials, members of trade unions, representatives of Professional Associations and universities and Chambers of Commerce, attended the public hearing. They made a considerable contribution to the issues related to the contract adjustment. The company executing the contract demanded to raise the price of the contract by 65%. The only institution presenting other calculations was the University of Morón, whose numbers varied between 45% and 54%. The hearing resulted in an adjustment of the contract value by 40.8 % from its original value. The decision was approved by the Decision Committee (Consejo Deliberante) with 21 votes in favour and three against.

The adjusted contract value was still lower than the other bids made by the loosing companies in the original bidding process in the year 2000. As a result, the Municipality of Morón had to spend less on waste collection than any other municipality of Buenos Aires province. The contract adjustment was performed transparently without deviating from the legal mandate to perform open bidding, and the process enabled the parties to protect public funds.[40]

## 3.4. EXTERNAL MONITORING OF THE CONTRACTING PROCESS

It is now widely recognised that Civil Society can have a crucial role in contributing to the transparency of public procurement processes, through a number of roles, including by being a source of expertise and an independent voice to raise issues or bring groups of people together.

[40] For additional information, please contact: Poder Ciudadano, Pilar Arcidiacono. Piedras 547 (C1070AAK), Ciudad de Buenos Aires, Argentina. Tel./Fax: +54-11-4331 4925. E-mail: pilar@poderciudadano.org, or see http://www.poderciudadano.org/.

There are different schemes whereby a civil society monitoring mechanism can be implemented. It can be a group of monitors, or an individual with some organisational backing. In any case, special efforts should be put in place in order to assure the independence of the monitor. These include 1) objective selection criteria, 2) a transparent method of payment, 3) unhindered access to information and liberal disclosure of information and 4) a system for the management of conflicts of interests. When designing the monitoring role for Civil Society, one should look at the following criteria:

- Monitors should be highly respected people of unquestioned **integrity**;
- Monitors should possess (or have easy access to) the required professional **expertise**;
- Where the local members of Civil Society do not possess the required expertise, they should promptly **contract such expertise** from outside, including where necessary from overseas. Non-availability of expertise means that problems may not be discovered, convincing professional corrective proposals could not be submitted, and the monitors would not gain the respect of the officials;
- Individual Monitors should not be subject to a veto by government;
- Monitors should have free and **unlimited access** to all relevant government documents, to all relevant meetings and to all relevant officials;
- It can be agreed that Monitors **raise issues** and complaints first with the authorities, and only when no corrective action is taken within a reasonable period of time, they would be free to go public or transmit the relevant information to the judicial authorities;
- Monitors should be prepared to offer a limited **Pledge of Confidentiality** regarding certain business type (proprietary) information; and
- Monitors should have **full access** to and review the tender documents, the evaluation reports, the award selection decision and the implementation supervision reports, technical as well as financial; they should participate in meetings and they should have the right to ask questions.

Where no suitable Civil Society organisation exists as yet, or where the government has insurmountable objections to the direct involvement of Civil Society, it may instead employ what in some US cases has been called an "**Independent Private Sector Inspector General**" (or IPSIG). The IPSIG, a private sector company or group of individuals, would normally come with the necessary expertise and it would have all the rights listed above for Civil Society organisations; such an arrangement can be acceptable provided the IPSIG is given not only full access but also has the contractual right to seek correction of any procedural problems or improprieties and, if no correction takes place, to inform the public or the judicial authorities of the impropriety.

**Ecuador. Independent Monitoring of Telecommunications Band and Sub-Band Auction Processes.**

Between 2001 and 2003, CLD, TI's National Chapter in Ecuador, introduced Integrity Pacts and performed independent monitoring in two different processes: 1) Auctions for the use of bands and sub-bands associated with the provision of the Wireless Local Loop (WLL): and 2) Auctions for the use of telecommunications bands and sub-bands associated with the provision of Mobile services (PCS or SMA). The goal of the Chapter was to improve transparency and accountability in the auction processes.

Both cases had the same approach and activities, which included:

- Signature of a **Cooperative Agreement** between CLD and CONATEL /NST establishing their mutual responsibilities. The Agreement included the implementation of the following items:
  - **Code of Conduct**, to be signed by all public officials and employees involved in the process;
  - **Guidelines for Transparency** in the Auction Procedure, outlining the process to be followed;

- **Integrity Pact**, to be signed by all bidders and the President of CONATEL; and
- Independent monitoring of the whole process by CLD.

• In the Code of Conduct, the public officials pledged to follow specific procedures on information handling and communications with bidding companies and not to accept to be hired by the company awarded the contract for a period of one year after it was signed. A Covenant of Confidentiality was signed by the members of the Bidding Commission as they were not required to sign the Code of Conduct. The Bidding Commission was composed of the President of CONATEL, representatives of SNT, the Telecommunications Superintendence and the Federation of Production Chambers, the Armed Forces Chief of Command, and the National Council of Modernisation.
  - The **Guidelines** included: access to information, careful management of privileged and confidential information and the elimination of discretionary selection criteria. The majority of the suggestions made by CLD were accepted by CONATEL and introduced into the documents,
  - The **IP** was voluntary in the case of the WLL auction, because the bidding documents were already drafted and sold to the possible bidders when CLD entered the process. It was agreed that it would only be implemented if all bidders agreed to it. A public signing took place where all bidders accepted to sign the IP. Those who qualified were permitted to take part in the financial bidding, which took place in the form of a public hearing. In the case of the PCS it was mandatory for all bidders as a requirement for pre-qualification. A public signing ceremony took place where all bidders agreed.

• CLD independently **monitored and contributed** recommendations at each stage and on every aspect of the auctioning processes. This included the following activities:
  - Adapted the IP methodology to the specific conditions of this auctioning process;

- Evaluated the content of the auction documents; these were published on
- CONATEL's homepage;
- Disseminated information on the process to all participants;
- Evaluated the content of the concession contract;
- Ensured that the process complied with the Cooperative Agreement;
- Advised CONATEL/SNT in the preparation and the subscription of the Code of Conduct;
- Convened meetings (carried out jointly with CONATEL) and attended all Meetings held by the Bidding Commission;
- Monitored the fulfilment of the conditions established in the IP; and
- Prepared periodic press releases for the general public regarding the development of the implementation process of the IP.

In the WLL process, seven companies purchased the bidding documents. Only two of the three band blocks available were awarded, but these for a price greater than the estimate for all three blocks (US$ 5.2 million). The whole project turned out very cost efficient as the monitoring costs were less than US$ 15,000. In the PCS process three companies technically pre-qualified, but only one of these presented a financial offer. The contract awarded by way of the auction was valued at approximately US$ 35 million.

Once the auction process was finalised, CLD issued a report describing how the process was conducted and the lessons learned.This procedure has been successfully implemented in Ecuador in twelve strategic procurement processes to this date, in the areas of telecommunication, electricity distribution, and hydro-electrical power generation.[41]

[41] For additional information, please contact:Corporación Latinoamericana para el Desarrollo (CLD). Andres Tobar, Juan Ramírez N35-10 y Germán Alemán, Quito-Ecuador. Tel: (593-22) 468-212/227 E-mail: atobar@cld.org.ec; also see http://www.cld.org.ec/ .

## 3.5. PRICE COMPARISONS

A successful process of reducing price gouging and bringing corrupt practices into light has been the collection and publication of price information. This can be performed by public agencies and by civil society as well. It can consist for example of a comparison of itemised prices for comparable goods or services across government agencies, and even better, a comparison between them and the market prices. For example, an initiative implemented by Transparencia Brazil includes an On-line interactive tool ( http://www.licitassist.org.br/desempenho ) aimed at providing comparative information on the public markets involving all 293 municipalities of the state of Santa Catarina in Brazil since the 1990s The tool provides market shares, distribution of contracts among firms and municipalities, quantities and unit price comparisons among a selected set of commodities (fuels and cement). Sets of social and economic indicators (the municipal Human Development Indicator and its three components, municipal automotive fleets) can be selected by the visitor to perform regression analyses. Overall, the database includes data from 72,000 different private providers, 120,064 public procurement events and 2,033,520 purchased items.[42]

## 3.6. RISK ANALYSIS (RISK MAPS) OF A GOVERNMENT OFFICE OR COMPANY

In the experience of many TI Chapters, Risk Maps are tools that serve multiple purposes. On one hand they are good diagnostic tools and on the other are awareness raising and political will building tools. Using a reference framework and a participatory methodology, different stakeholders to a procurement system (within a specific agency or for a particular contracting process) identify and qualify together particular areas of vulnerability and sources of corruption risks. This allows them to design mechanisms to address the risks.

**Peru. Risk Mapping in Fuel and Lubricant Procurement.**

Proética, the Peruvian National Chapter of TI, in 2004 signed a Memorandum of Understanding with the Regional Government of Lambayeque to monitor the centralised procurement process of fuel and lubricants for the Government's vehicles through the implementation of an Integrity Pact. This was the first time that a public bid was called to supply these products. The total cost of the procurement amounted to around US$ 308,000. It aimed at making regional government contracting less corrupt by establishing greater transparency and instituting civil society oversight of the procurement process.

The approach included three elements within the process leading to an Integrity Pact:

1. A participatory discussion within the Government of Lambayeque that comprised the elaboration of a corruption risk map and a declaration of commitment from the officials to fight those risks;
2. Expert support from Proética in analysing the bidding documents; and
3. Creating opportunities for public participation in discussing the bidding documents.

**Risk Mapping:** Proética facilitated a workshop where a Corruption Risk Map concerning the fuel procurement process of the Government was elaborated by the participants. It closed with the signature of an ethical declaration by participants where the parties committed to fight against those risks. Among the risks identified where the common practice of fuel adulteration and the participation of only a few bidders, giving indications of cartelisation.

**Expert Advice:** Proética commissioned experts in the area of fuel and its distribution in Perú to revise the tender documents. Various

[42] Further information on the project might be sought by writing to the address tbrasil@transparencia.org.br .

legal and technical suggestions were crucial to address a series of deficiencies were accepted by the Government and incorporated into the bidding documents.

**Pre-publication And Public Discussion Of The Tender Documents:** The final version of the tender documents was posted on the Government's and Proética's internet portals for public comments and questions. At the beginning, there were no dissenting opinions after the pre-publication of the bidding documents and feedback was limited. During the consultation process the interested parties addressed the President of a Special Committee in charge of conducting the bidding process with their observations, doubts, clarifications and suggestions on the bidding documents.

**Integrity Pact:** An Integrity Pact was signed between all Government officials involved in the procurement process.

**Evaluation of offers:** The evaluation took place in two stages. First, a technical evaluation was made to assess the quality of the offers. Then the offers were qualified according to economic and financial criteria.

The process and in particular the risk maps methodology allowed to identify particular corruption risks and other sources of inefficiencies.[43]