

# **CSIS WORKSHOPS ON CORRUPTION IN INTERNATIONAL BUSINESS**

## ***Session One: Corruption in Government Procurement***

***July 12, 2001***

### **Discussion Summary**

**On Thursday, July 12, the Scholl Chair convened a Workshop on Corruption in Government Procurement, the second in CSIS's series on Corruption, Counterfeiting, and Cyberfraud. Helen Sutch - Sector Manager, Public Sector Group, Department of Poverty Reduction and Economic Management, World Bank; Michael Woscoboinik - Office of the General Counsel, Inter-American Development Bank; John Ellis - USTR-WTO Affairs; and Miguel Schloss - Executive Director for Latin America, Transparency International led the group's discussion.**

**Participants included Lars Bjerde of Ericsson, Arnaud de Borchgrave from GOC at CSIS, Arthur Downey, Baker Hughes, Inc., Michael Gadbaw, General Electric Company; and, Michael Ryan, Rolls-Royce North America, Inc. They focused on improving states' governance environment through increasing transparency in the procurement process. They also shared experience and knowledge of the potential of e-procurement to decrease corruption. The next in a series of three workshops planned by the Scholl chair will deal with implementation of the OECD convention on bribery and will be held in September.**

***Helen Sutch – Sector Manager, Public Sector Group, Department of Poverty Reduction and Economic Management, World Bank***

- In 1996 the World Bank began to focus on corruption in government procurement. President Wolfensohn offered to help any country in reducing corruption. Latvia was the first country to accept the World Bank's offer and Ms. Sutch was part of the team involved in working with the Latvian government.
- The key to the World Bank's new approach is a shift of focus toward the environment of governance in which procurement takes place. While the Bank previously focused on technical improvements to government procurement, Ms. Sutch argued that focusing on building a "state of the art" procurement system without taking the broader context of governance into account is doomed to fail.
- There are several ways in which the governance environment can encourage or hinder corruption in procurement.

- o Political appointees can be either important watch dogs or corrupt themselves;
  - o Functioning courts can serve as a useful enforcement and oversight mechanism; dysfunctional or weak courts render contracts unenforceable;
  - o Effective and efficient civil service is needed to maintain records critical to developing transparent procurement systems;
  - o Governance does not mean only *government*. It also means the presence and strength of civil society and an independent media to scrutinize government practices (in the presence of transparency).
- The Bank has identified several “red flags” that alert observers to the potential presence of corruption (such as short tender periods; advance information to favored bidders; and, biased evaluation criteria). This has raised a sensitive question for Bank employees: when should a bank staff member blow the whistle on corruption? They lack the right to impose judicial action, and there is real concern that Bank employees could endanger themselves. The Bank has incorporated a section into their training for new staffers on how to deal with instances of corrupt practices when they are suspected or observed.
- The Bank focuses on reforms to combat corruption. Even simple policies such as having standardized bidding documents, and distinguishing between evaluation and pre-qualification criteria are often lacking in even more developed countries.
- E-procurement is another promising program, though its adoption has been too recent and isolated to draw general conclusions about its effectiveness in fighting corruption. In one successful example, the cost of purchasing hospital equipment in one South American country dropped 45% after that country adopted e-procurement practices.
- The World Bank has taken internal measures to combat corruption. On its web site the Bank publishes a “black list” of companies that it refuses to conduct business with given their history of corrupt business practices.
- Unfortunately, the Bank’s efforts at reducing corruption are useless without the presence of groups in the country who want reform. To address this fact, the Bank works to create demand among key domestic groups such as business, the Finance Ministry, the civil service, taxpayers, and watchdog groups. By making these groups aware of the preconditions for successful reforms (accountability mechanisms, transparency, monitoring, audit capacity, credible appeals and remedies, and credible penalties) the Bank tries to develop a core of groups invested in reducing corruption.

***Michael Woscoboinik – Office of the General Counsel, Inter-American Development Bank***

- One of IDB’s main approaches to countering corruption is on the ground supervision. IDB has offices in all borrowing countries. These offices review tenders, evaluate reports, decisions, and final contracts. This helps to ensure that bids are not tailored to specific suppliers. The fact that IDB is on the ground in the countries with staff who are knowledgeable about the peculiarities of the country helps decrease the incentive and opportunity for corruption.

- IDB has also adopted specific measures to minimize the chance for corruption:
  - Encourage express language in contracts spelling out remedies
    - Expel corrupt firms
    - Freeze loans
  - Develop standard bidding documents
  - Develop a framework against corruption
    - Increase the quality of risk analysis
    - Support executive agencies that carry out procurement
    - Provide external concurrent audits
  - Provide an independent oversight committee
  - Improve the overall climate through technical assistance loans, training, help with legislation
  - Provide support for financial management agencies through loans

***John Ellis – Office of the U.S. Trade Representative, WTO Affairs***

- Corruption is not the main focus of trade agreements, but international trade agreements certainly help strengthen the international rule of law.
- The link between trade and corruption is weak and controversial in the WTO. There are, however, specific measures that can be included in trade agreements to decrease corruption, such as:
  - Transparency requirements
  - Limiting discretion
  - Procedural provisions (e.g. in WTO agreements)
    - WTO Agreement on pre-shipment inspection
    - Customs valuation (Implementation of Article VII of the General Agreement)
- Perhaps the most potentially important is the WTO Government Procurement Agreement, which requires the public notice of intended procurement and final awards. This increases transparency; systematizes procurement procedures for bidding and award of contracts; and, establishes standards for administrative and judicial review.
- So far only 27 states have signed the GPA, as it is optional for WTO members. However, the FTAA will have a mandatory chapter on government procurement, doubling the number of countries with formal international commitments in this area.
- If anyone doubts the importance of these procedures, informal accounts indicate that Mexico's procurement procedures have changed dramatically because of the bid and award standards included in NAFTA.

***Miguel Schloss – Executive Director for Latin America, Transparency International***

- One focus of TI is developing tool kits, or practical measures for combating corruption: the question is how to deal with corruption without changing too

much at once (please see <http://www.transparency.org/anti-corruption/index.html>). TI's work includes:

- o Price Comparisons: There is a lot of procurement that doesn't go through competitive bidding, so TI encourages agencies to keep records of what price is charged and publish these records in newspapers or other public documents. This allows the procuring agencies and the public to see which agencies are being fleeced. Over time, observers should see prices converge downward. Sunlight is the best disinfectant.
- o Public Hearings: In Argentina, the process of bidding on a new metro line was subjected to public hearings. One technical expert pointed out that during pre-qualification, only one firm could win the bid and recommended changes to pre-qualification to enlarge the pool of bidders. This process also allows bidders to observe each other.
- o "Integrity Pacts" (Competition Specific): While TI applauds the World Bank and IADB, it wants to identify simple rules of the game to allow individual transactions to take place while a more permanent infrastructure is being built. These rules can include:
  - Non-bribery commitment by bidders
  - Disclosure of payments
  - Let all members of an Integrity Pact check on each other
- The key point is that procurement opens up when the facts are made known; publicity on prices and bidding information is key.
- The two main intellectual architects for e-procurement in Mexico and Chile were members of TI.
- While TI adopts a micro- approach to reducing procurement, there are limits to this method. TI hopes that its work sparks ripples through the entire system, but micro- efforts do not necessarily cause structural change. On the flip side, macro approaches are very broad and overlook the (significant) differences among states.
- A number of TI chapters are monitoring WB projects. TI is working on compiling these analyses to see whether there are consistent gaps in how WB projects respond to states' needs. TI is also conducting a self-study of its own projects to see what generalizes across states. It will use this to launch a pattern of automatic feedback from projects.
- TI is also studying sector-specific transnational transactions. One example is contracts for petroleum procurement and distribution in Sub-Saharan Africa (accounts for 20-25% of the area's Balance of Payments and 40% of state revenues). If you look downstream from product recovery to refining to distribution, governments are losing \$1.5B/year because of corruption in procurement. This is related to discretionary power in the public sector. The more the government is involved in these downstream transactions, the more money gets lost.

### ***Key Discussion Points Following the Presentations***

- When asked whether it seemed that transparency itself is a fix that can improve the governance environment, Sutch said it is important not to ignore micro-level

programs. It is important to undertake these programs with a good understanding of the macro-drivers of corruption. Taking this focus helps to create incentives that put the pressure on the process (transparency *and* accountability). In Uganda, less than 20% of government expenditures on education made it to schools. Five years later, after people in locales where funds were directed were told how much money they should expect from the government at different times throughout the year, that amount reached 90%. But you also need macro-projects that identify where the money is being stolen.

- While the World Bank conducts an internal audit with appropriate safeguards when determining who to place on its Blacklist, Sutch said the Bank does not suggest that others rely on the Bank's list because of questions regarding the legal standards of proof.
- Regarding TI's activities in the Persian Gulf, Schloss noted the region is difficult because governments are opaque. TI tells its representatives in the area that TI doesn't want martyrs and individuals should be careful when organizing.
- Citing Mexico's effective system, GE asked why the large banks have not gone farther in pushing for e-procurement. Woscoboinik noted that it is an area the IDB is pursuing. GE does a significant amount of public auctioning on-line. It can be done and is effective, so the public sector should not be substantively different. John Ellis remarked that he hears developing countries express fear that they will be left behind on e-procurement and they can't take advantage of it; this misperception is something that needs to be corrected.
- GE also asked whether the panelists could make a judgment about the extent to which the process of democratizing states leads to corrupt procurement practices (under the logic that elections need parties and parties need financing). Sutch replied this is a problem. While the WB's mandate prevents it from dealing with political issues generally, the Bank can act if conditions of corruption in the country harm development (so the WB has become more aggressive on this lately).
- TI-USA noted that a disconnect seemed to exist between what MDBs are doing and what trade negotiators are trying to do. To bridge the divide, the Banks should reexamine the proposal that MDBs require codes of conduct on loans. Ellis noted that the USTR has been frustrated in pursuing commitments in trade forums on these issues. It is hard to convince WTO states that this is worthwhile. GE suggested that it's feasible to structure MDB loans that are conditioned on support of the WTO Procurement Transparency Agreement. Sutch pointed out that the World Bank cannot impose conditions that bind Parliaments, but it can delay disbursements.
- Raytheon pointed to the Defense Industry Initiative: industry got together and set anti-bribery compliance standards. There is no reason why other sectors cannot.
- In a final comment, Sutch noted that it is important to remember that perfect transparency practices are meaningless unless states have good record keeping. One crucial and often-ignored point is that many governments lack basic record keeping and thus are incapable of adopting transparent practices even if they want to.