

# Corruption in Public Procurement Risks and Reform Policies

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## Sources of corruption risks

- ❑ The volume of fiscal resources allocated through public procurement

2005-2006

BGN 15.2 billion (about 17% of GDP)

2007

BGN 6-7 billion (10-12% of GDP)

Expected growth of 1 billion per year towards the average EU level (16.3% of GDP).

- ❑ Dominated by public works

Over 50% (over 80% with Belene NPP).

- ❑ Public works and provision of services account for more than 2/3 of the value of public procurement contracts.
- ❑ Complex engineering projects allow for relatively limited bidding and significant expenses for consulting services.

## Level and spread

- ❑ The share of bribers is down from 54% (2002) to 10% (2007).

### BUT!

- ❑ Evidence of high corruption levels from business experience:
  - ❑ Over 80% of the participants report various violations of the procedures;
  - ❑ For 60% the corrupt procedures in public procurement are “widely spread.”
- ❑ The value of the bribes increases:
  - ❑ 7.4% report bribes of over 20% of the contract’s value.
- ❑ The share of the firms taking part in procedures is decreasing:
  - ❑ From 43% in 2002 to 14% in 2007.

# The Explanation

- ❑ Random corruption is crowded out by well structured networks of influence, where “non-members” have no chances.
  
- ❑ Corruption migrates from the administrative to the higher political levels of power.
  
- ❑ Competition in public procurements procedures is limited, thus incurring significant economic and fiscal costs.

# The Cost

## ❑ Direct fiscal cost:

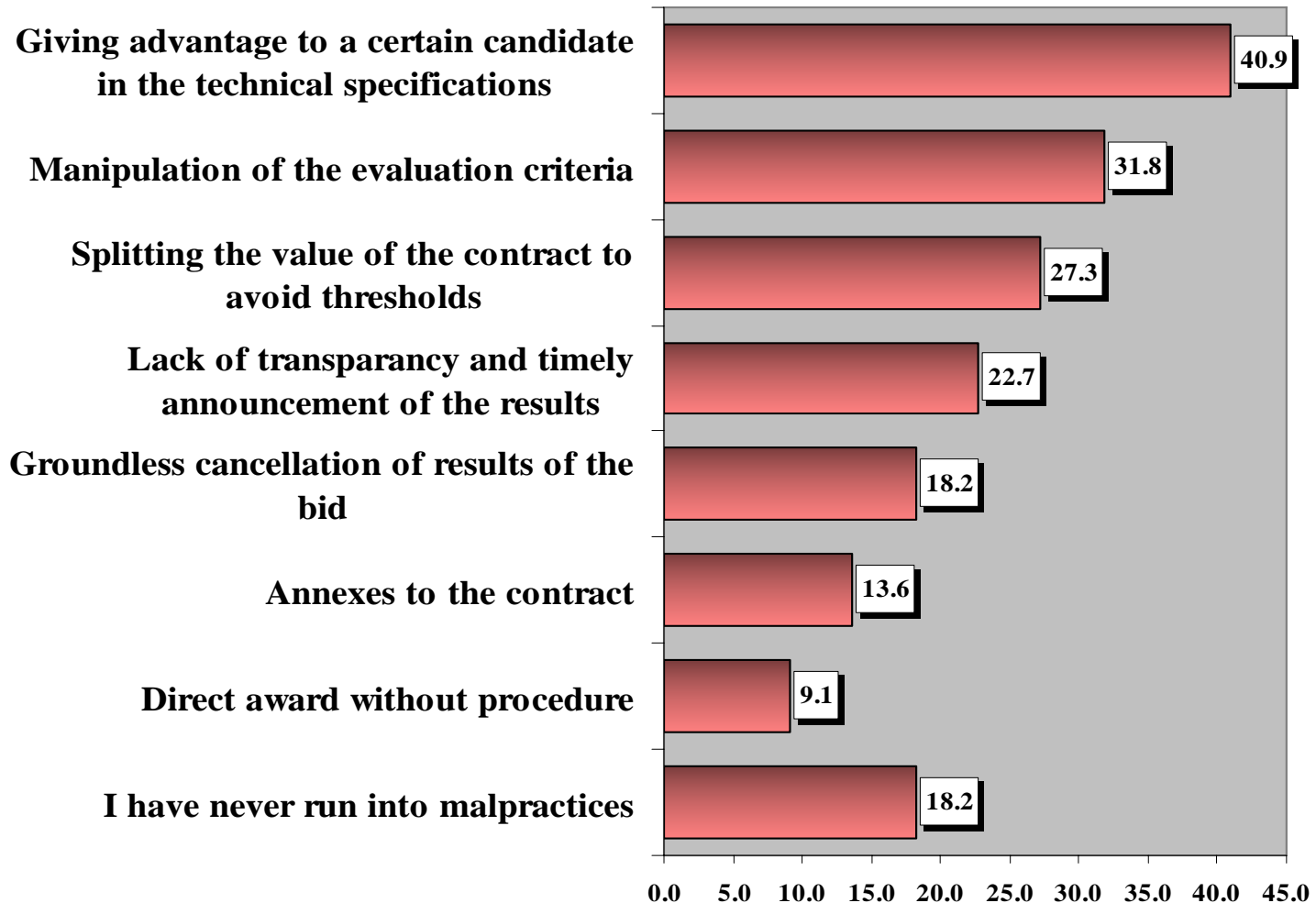
**2.4% of GDP;**

**BGN 1.2 billion in 2006; 1.4 billion in 2007.**

## ❑ Indirect economic costs

- ❑ Distorted market signals and damage to competition
- ❑ Crowding out of compliant bidders
- ❑ Increased compliance costs, especially for the SMEs

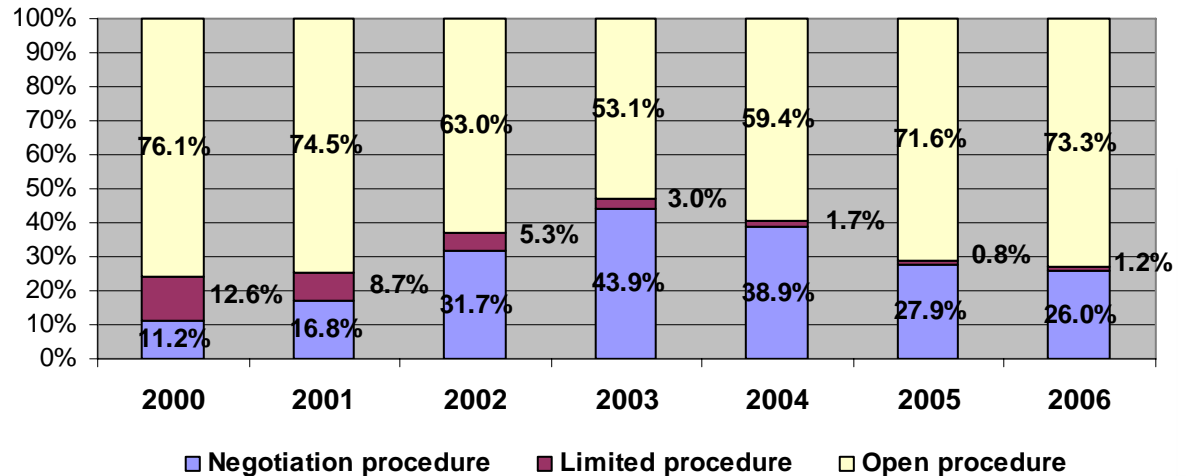
# Corruption Practices



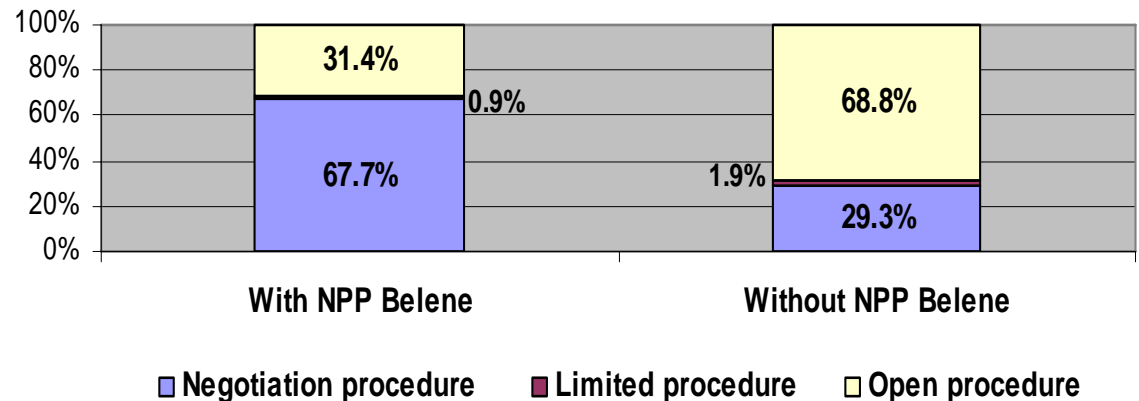
Source: IMD

# Corruption Risks: Negotiations

2000-2006  
% of the contracts signed



2006  
% of the contracts signed



Source: IMD

## Implementation stage

- ❑ The LPP regulates the procedure until the award of the contract, ruling out any annexes. The implementation of the contract itself is not covered by the Law and its control and sanctions mechanisms.
- ❑ This is of great importance in public works contracts and provision of services.
- ❑ This is a serious departure from the EU standards in project management, including the management of EU funds, where it is the outputs rather than the contract that matters and is subject to scrutiny.



# What is to be done?

## Regulatory Framework

- ❑ Goal: maximum competition at minimum compliance costs for the bidders.
  
- ❑ The transposition of EU norms is not the ultimate goal but only an instrument (and not the prime one) in the fight against corruption.

# What is to be done?

## Regulatory Framework

- Appeals procedure
  - Anti-trust committee, or administrative courts
  - Who can appeal
- Cancellation of bidding results
- The implementation stage
- To provide the framework for the competitive allocation of EU Structural Funds
- Sanctions and control: institutional versus personal responsibility

# What is to be done? Ex-post control

Public Finance Inspection	2005		2006	
	Number	BGN mil.	Number	BGN mil.
Registered procedures (1)	10583	3296	12134	11880
Audited (2)	6399	1200	2387	419
Violated procedures	1609	567	483	143
Violations established	2551	567	863	143
under the LPP	651	515.3		
under the RSPP	1900	51.7		
Share	74.5%	9.1%		
Failures to conduct procedures	641	98.5	193	39.8
Total violations and failures (3)	2250	665.5	676	182.8
Share of audited procedures (2/1)	60.5%	36.4%	19.7%	3.5%
Violations/audited procedures ratio (3/2)	35.2%	55.5%	28.3%	43.6%

# What is to be done?

## Other anticorruption measures

- ❑ **Corruption risk assessment and management**
  - ✓ Compliance with the Letter of the Law or the Spirit of the Law. Most procedures incur excessive cost to society in full compliance with the law
  - ✓ Indicators of corruption risks and effectiveness of control
- ❑ **Measures addressing political corruption, i.e. rules of the game concerning**
  - ✓ Financing of election campaigns and political parties
  - ✓ Conflict of interest and lobbying
  - ✓ Public-private partnerships

## Public Procurement in the Energy Sector - Specifics

The largest investment projects:

- Procurement dominated by sector (business) employers
- Traditionally the largest employers
- High dynamics – expected growth for 2007 amounts to over 50% compared to 2006 (source: BIA):
  - NPP Kozloduy – from 82 BGN mn to 100 BGN mn;
  - NEC – from 243 BGN mn to 412 BGN mn;
  - Power Production – from 197 BGN mn to 357 BGN mn;
  - Power Distribution – from 200 BGN mn to 280 BGN mn.
- Structural nature of the procurement in the energy sector
- Very large turnovers
- Intensive government intervention
- Lack of competitive environment

## Main Sources of Corruption Risk

- Public regulation within the limited market conditions
- Reliance on the import of energy sources, supplied under monopolistic conditions
- Lack of transparency of the energy export deals
- High technological risk in the sector and limited opportunities for public debate. Public sensitivity on the nuclear energy subject
- Slow privatization with unsatisfied public expectations and many cases of government-owned buyers.

## Specific Forms of Diversions

- Evasion of competitive procedures
- Assignment of public useless and/or unjustified procurements from the viewpoint of the economic expedience
- Assignment of disadvantageous procurements
- Failure to apply the Law on Public Procurement exactly on the largest procurement deals.

## Evasion of Competition Procedure

Results for 2004- 1/7/2006:

- Only 21% open procedures;
- 51.3% procedures for negotiation, including the acceleration at RSPP;
- Only 0.7 % transactions on the commodity exchange (16 out of 2139), including for supplies typical for this specific market

*Remark:* The data does not account for the contracts signed for assignment without conducted procedures in LPP or RSPP!



## Useless Procurements

- Initially publicly useless – as goals and no public needs to satisfy
- Inefficacy by design
- Unjustified from the viewpoint of the ultimate results
- Decisive role of the consulting procurements
- Dominated consulting market
- Connected participants: consultants, contractors and sub-contractors
- Impossibility to instigate competition

## Disadvantageous Procurements

- Inevitable results stemming from the lack of competition environment
- Peculiarity of the technical specifications in measuring the efficiency of:
  - The supply of energy sources;
  - The technological equipment;
  - The consulting.

## Possible Indicators for a Monitoring System as a Mean to Counteract

- Groundless increase of the expenses of the companies involved in power generation and distribution over a given period of time;
- Groundless profit reduction over a given period of time with parallel unaccountable increase in the profitability of the concomitant activities, done on the basis of outsourcing or other contractual partners of the associations;
- Immediate altering of the government appointed boards of directors after elections held without transparent and clear motivation (indication of seizure of high-profit/high-resource economic units);
- Multiple consequent conduction of procedures for the assignment of public procurement with one and the same subject;
- Groundless cessation of public procurement assignments;
- Usage of one and the same consultant for various roles and level of domination in the market of consulting service;
- Systematic evasion of the commodity exchange transactions at typical hypothesis of the energy sources and related commodities;
- Cases of connection of firms, appearing to have various roles in one and the same investment project: engineer-consultant/purchaser or consultant in privatization procedure/contractual partner of company in the generation, supply or distribution of energy.