

# Procurement procedures and the size of firms in infrastructure contracts

Tina Søreide\*

Chr. Michelsen Institute (CMI)  
Bergen, Norway

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## Abstract

Tender rules are generally more elaborated for large infrastructure contracts compared to smaller ones. The paper argues, however, that there are particular opportunities to bypass or cheat on the tender rules for large and complex contracts. Based on a recent study of the experiences of Scandinavian firms in international markets, the paper finds that the larger the firms, (i) the better opportunity they have to influence the tender procedures; (ii) the more frequently they find tender-results to be predetermined; (iii) the lower their trust in the procurement procedures' capacity to prevent corruption; (iv) the more frequently they are asked for *quid pro quos*; and (v) the more frequently they find the outcome of tenders to be influenced by political pressure. The paper also examines the various political interests at stake in such contracts, political corruption included.

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\*This paper is a draft. Comments are welcome. E-mail address: tina.soreide@cmi.no. I would like to thank Micheal Lawrence and Odd-Helge Fjeldstad for valuable comments.

# 1. Introduction

Elaborated procurement procedures are no guarantee for a superior combination of price and quality in large infrastructure projects. Tender procedures behind large projects, like the construction of a highway, a tele-communication network or a major seaport, can be manipulated in several different ways. Furthermore, large infrastructure projects appear particularly prone to political interventions, addressing, for instance, regional or distributional considerations, unemployment, and protection of domestic industry. This paper addresses the particular exposure of such projects to tender manipulation, business corruption, and private benefits for the political elite.

The paper is motivated by the obvious importance of preventing misuse of public spending. The role of private firms in establishing well-functioning public service delivery and infrastructure in developing countries is well documented (McKenzie and Mookherjee, 2003; Nellis, 2003; Meggison and Netter, 2001). Their role is, however, also recognized when it comes to tender manipulation and business corruption (TI, 2002; Hellman et al., 2000; Della Porta and Vannuci, 1999). Examples of scandals in infrastructure procurement include the Lesotho Highlands Water Project, where the project's Chief Executive were found guilty in receiving bribes from multinationals to secure them contracts; and the telecom case in Haiti, where President Aristide allegedly got kickbacks from US telecom companies to provide them with benefits in infrastructure contracts. Illegal business practices are often difficult to prove, and the scandals will sometimes become apparent only in the form of inefficient or useless results, not necessarily in the identification of offenders and court cases. Relevant examples are the Yacyretá project, one of the largest hydropower projects in Latin America, from which the power is now being subsidized by the government because of huge cost overruns under the construction process; and the Bataan nuclear reactor in the Philippines, built at a cost of more than \$2 billion, and which so far has failed to produce a single unit of electricity.

Large-scale corruption took place in several of these projects in spite of the presence of tender procedures that had been introduced to ensure a fair assignment of the contracts. Massive waste of public resources could happen in spite of an uttered political will to improve welfare for a local population. The failures of reaching a welfare optimizing outcome through infrastructure contracts are, accordingly, not only a question of procurement procedures, and should not be treated as so.<sup>1</sup> The problem requires a broader approach, which also addresses the more sensitive issues of political corruption, involving 'connections', political pressure, predetermination of contracts, motivation behind renegotiations, rent-seeking, grabbing, quid pro quos, signature bonuses, or whatever the different mechanisms are called.

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<sup>1</sup> Corruption is an issue not of concern for the WTO, according to Weber (2003), because the problem is being fought 'automatically' by new and better procurement procedures. The WTO discussion referred to can be found in "Report (2003) of the Working Group on Transparency in Government Procurement to the General Council", para.14. See also WT/WGTGP/M/18 and WT/WGTGP/W/41, available on the WTO website.

This paper examines some of the limitations of infrastructure-related procurement procedures. It is organized as follows: The first part is a presentation of the results of a business-survey on corruption and procurement-related issues. The survey was conducted among Norwegian export firms in 2004.<sup>2</sup> The survey sheds light on the perspectives of firms, including the perspectives of firms that have lost contracts because of misprocurement. The survey found that large firms have more opportunities than small firms to influence the outcome of tender procedures and also to bypass parts of the tender procedures.

On the basis of these results, I will go on to a more general discussion about the failures in public procurement for infrastructure projects. The procurement-related challenges will not be identified as the result of institutional defaults in the responsible bureaucracies. They are instead described as specific opportunities to manipulate tenders in infrastructure industries, from the perspectives of firms as well as politicians and high-ranking civil servants. Policy implications are presented in the conclusion.

## 2. The business-survey: Procurement and the size of firms

### 2.1 Methodology

The objective of the survey was to provide detailed empirical information about firms' experiences with corruption in overseas markets, their attitudes to it, and the actual choices they make in response (Soreide, 2006a). The survey focused on Norwegian firms. Norwegian industry is oriented to overseas markets and is well exposed to international business cultures and attitudes. The main export sectors of Norwegian industries are, however, also perceived to be among the most prone to corruption, notably construction, communications (IT/telecom), and energy (gas, oil, electricity). In spite of this, Norway scores well on corruption rankings, such as the Corruption Perceptions Index (CPI) by Transparency International (2005), and is also commended by the OECD for its implementation of a new anti-bribery legislation (OECD, 2004). Thus, many Norwegian firms probably experience a combination of the pressures of operating in international markets where corruption is considered a general problem and the obligation to respect new international restrictions on bribery.

The survey, which was conducted in cooperation with the Confederation of Norwegian Enterprise (NHO), had three components: (i) A pilot study involving interviews with executives in charge of international sales and marketing in seven large firms<sup>3</sup>; (ii) a mail questionnaire with about 100 questions on corruption to which top managers in 82 exporting firms responded (500 firms had received the questionnaire); and (iii) a smaller survey of Norwegian embassy staff in countries outside the OECD area.

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<sup>2</sup> See Soreide (2006a) for a full presentation of the survey, which included close to 100 questions on corruption and also a survey of the perspectives of Norwegian embassy staff on bribery in international business transactions. The questionnaires can be downloaded from the following web page: <http://www.cmi.no/research/project.cfm?proid=309>

<sup>3</sup> Three of these firms were on the FT list of the 500 largest companies.

All the firms operated internationally. One third had done so for more than 30 years, and about half for 10-30 years. Almost half the firms also produced goods outside Norway. More than one third said that they had projects for foreign governmental institutions. Other characteristics of the responding firms are summarized in Table 1.

*Table 1: The firms responding to the business survey*

Sectors of operation		
Construction		20%
Oil, gas and power transmission		20%
Agri/food industries		15%
Telecommunications and IT		13%
Heavy industry		8%
Other types of service		8%
Consulting		6%
Light manufacturing		5%
Turnover		
<i>Small firms</i>	(less than NOK 100 million <sup>4</sup> )	45%
<i>Medium sized firms</i>	(between NOK 100 million and one billion)	33%
<i>Large firms</i>	(above NOK 1 billion)	23%
Competitive pressure		
Hard to make profits on main products or services		44%
Not hard to make profits on main products or services		55%
Regions of operation		
Europe, USA/Canada, East European countries and Central Asia, Asia other than mainland China, Latin America and the Caribbean, Sub-Saharan Africa, the Middle East and North Africa, mainland China and Oceania.		

*Note:* For the sake of anonymity, ‘oil, gas and power transmission’ were treated as one category. Competitive pressure is difficult to measure. The respondents to this survey were asked if ‘the prices for their main products or services were forced to a level that makes it hard to make profit’. The regions of operation have been ranked in this table according to their reported importance for the firms.

The firms’ responses were analyzed using non-parametric statistics. Given the sampling and size of this dataset the results will not allow for statistical generalizations. The results presented are the reported frequencies in the dataset, cross-tabulations, and the results of probit analyses. Correlations described as ‘significant’ or ‘clear’ are statistically significant at the five percent level or better. It should though be noted that the reliability of empirical research on corruption is always uncertain. The many reasons to expect some form of bias in the responses suggest cautious reference to exact percentages.<sup>5</sup>

## **2.2 The function of procurement procedures and tender corruption**

The majority of the responding firms reported to have encountered some form of corruption in their international operations. When asked about the extent to which

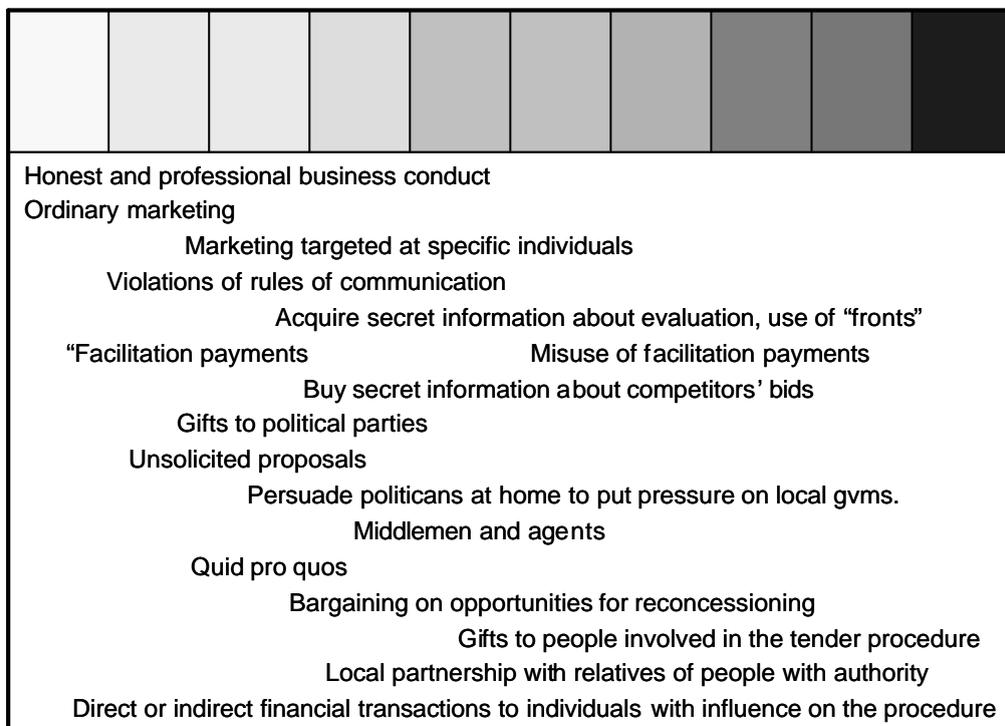
<sup>4</sup> 1 billion NOK is about \$160 million.

<sup>5</sup> See Soreide (2006b) for a critical assessment of data on corruption.

‘unethical business practices have placed the firm in a more adverse competitive position’, almost 70% claimed that unethical business practices by competitors had certainly or probably cost them important contracts. 42% said that they had reason to believe that competitors influence tender procedures unduly. Not surprisingly, few respondents admitted to practising bribery themselves. 10% had agreed to meet a request for payment from an agent, an adviser or a consultant in the knowledge that this payment would most likely be used for bribery. 27% of the firms reported that they had been required to give valuable presents or bribes to be able to operate in certain markets.

Note, however, that there are large grey zones between legal and illegal business practices. Figure 1 illustrates the scale from honest and professional business conduct, on the one side, to undue influence and clear cut corruption, on the other. While most forms of tender influence made by firms can be placed on this scale, their ‘greyness’ and illegality will usually be uncertain.

Figure 1: Influence on tenders – not necessarily corruption.



*Influence on tenders*

Marketing strategies verge on corruption when representatives of the customers are offered benefits of significant personal value, particularly when the benefits have a job-related aspect, such as business excursions and tickets to events to which job contacts are also invited. Several of the persons interviewed as part of the pilot-study admitted that the intention behind these gifts is similar or identical to the purpose behind bribery.

There are of course ways of influencing clients that are less direct. For instance, due to their undoubted expertise, firms are frequently asked to advise clients on technical aspects of tender specifications, even if they are among the competitors for the contract. This consultative service will in some cases represent an opportunity to influence the specifications in a direction that benefits the firm itself or one of its associates. One third of the firms to this survey found themselves sometimes able to influence or advise clients on tender specifications.

#### *Predetermination of contracts*

The practice of designing contracts to fit the offer of one specific tenderer was reported to be quite common. 41% of the firms said that tender specifications happen to be designed to fit the offer of one specific company. This perception was most common among the largest firms. The technical tender procedure may appear correct on the surface even though the qualifications have been set to give an advantage to a particular company. This firm will thus offer the lowest price, and the formal procedures appear satisfactory. Such bid rigging will often affect the choice of technology, a choice that typically has more consequences the larger the project. The choice of technology will, for instance, often directly affect what subcontractors are used. Therefore, also smaller firms can have incentives to influence the relevant decision-makers in large projects.<sup>6</sup>

#### *Do tender rules prevent corruption?*

The results on pre-selection and pre-tender contact cast doubt on the efficiency of tender rules in controlling corruption. The views of the respondents were primarily that procurement rules are important, though not in themselves a good anti-corruption tool. In fact, as many as 55% of the respondents did not think that tender rules could prevent corruption. Fifteen percent said that tender rules do function as an obstacle, while only six percent considered tender rules to be an *efficient* obstacle to corruption. However, there are substantial variations between firms in their views about procurement procedures. Compared to the total sample, large firms, firms with production plants located in several countries, and firms with many years of experience in international markets had significantly lower confidence in the ability of procurement procedures to prevent corruption.

#### *Rules of communication*

One specific problem pointed at by the respondents is that rules of communication are often neglected in tender procedures. Although access to information and transparency are important to ensuring fair competition, it is crucial to keep critical information about the bids as secret as possible. Communication rules are supposed to prevent the distribution of such critical information, which for obvious reasons is a frequent object of bribery. A central element in most formal tender rules is the way the contact between

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<sup>6</sup> Pre-selection of bidders is not necessarily a result of corruption. Clients may be obligated to use tender procedures, regardless of justified preferences for a specific company, for instance because of satisfaction with its past performance. According to the business people interviewed, pre-selection is also applied by clients to control the spread of contracts when there are few competitors in order to reduce their possibilities to operate as a cartel.

client and bidders should take place once the tender process has started. At this stage, the rules often require that communication between one firm and the client is copied to all tenderers. Nevertheless, 49% of the respondents said that there will often be negotiations between tender participants and decision-makers during a tender procedure, without having critical information copied to other tender participants. Less than a fifth of those reporting communication all through the tender process said that such communication is usually copied to all tender participants.

These communication problems were reported to be most common among the largest firms. The contracts are in general more complex at this level, and they will often include details that need thorough discussion. These factors, however, will also make it easier to cover up corruption. Representatives from large firms generally associated a lack of respect for these communication rules with unacceptable business procedures, and found it “very problematic” when the rules were not followed. They considered the rules of communication particularly important for complex contracts.<sup>7</sup>

### *Diplomatic pressure*

The outcome of tenders on big contracts is sometimes affected ‘from above’ by diplomatic pressure to the benefit of one specific firm, specifically when the client is a foreign government. The pressure may take the form of a subsidy, such as an export credit deal, aid to the buyer linked formally or informally to the purchase, commercial pricing issues, impediments to trade, or tied defense/arms deals. This kind of pressure may reduce the prospect of ending up with the most beneficial outcome to the host country’s citizens. The link to corruption becomes clear when the selected firm has paid its own government to put pressure on the client.<sup>8</sup> However, the local welfare implications of such political influence are independent of the type of ties between the bidding foreign firm and its own government, and even without such a payment, it resembles corruption. The buyer is, in effect, bribed by the contractor’s government, while the responsible minister can refer to jobs and exports.<sup>9</sup>

One third of the firms covered by this survey believed competitors had obtained contracts through diplomatic pressure. The Bribe Payers Survey conducted by TI found significant differences in the propensity of governments to influence the international business ventures of domestic firms - the USA, France, and the UK appear to be

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<sup>7</sup> Although a low respect for communication rules seems to reduce the efficiency of tender rules designed to prevent corruption, it should be noted that a violation of communication rules is not necessarily a result of corruption or a lack of respect for the rules among firms taking part in a tender. To reduce prices or to make a certain firm win the tender, the client may have an incentive to inform one or several of the competing tenderers about the secret tender information.

<sup>8</sup> The pressure can also be a threat of political sanctions. According to people interviewed for this survey, there are countries where large firms sometimes pay their national politicians, for instance in the form of party financing, to sanction a client, or the client’s government (when the client is a firm), after the contract has been given to “the wrong firm”, a competitor.

<sup>9</sup> “...without mentioning the fact that such jobs are in fact subsidized” – from an article in *The Economist*, “Don’t be salesmen”, 1 February 1997

particularly active (Transparency International, 2002).<sup>10</sup> Several participants in the business survey presented here considered political pressure to the benefit of international competitors a significant disadvantage and called for more political assistance from Norwegian authorities. Some said, however, that Norwegian authorities tended to prefer Norwegian firms in governmental tenders (that are supposed to be fair and unbiased), and that foreign competitors probably considered this a comparable disadvantage. One out of five of the firms covered by this survey had received assistance from Norwegian governmental institutions to guarantee the financial aspects of the deal or to ensure a specific contract in other ways.

*Quid pro quo* is a different form of political pressure, still connected to big contracts, but now instigated by the client government. It refers to a reciprocal exchange in which the chosen firm provides benefits for local governments and their constituents. For example, a multinational firm may promise to build a school or infrastructure, or to use local human resources during their operations in the given country. Almost 20% of the firms covered by this study reported that they frequently experienced a request for a quid pro quo, 33% reported seldom, and 35% said that they never experienced such a request. Local content demands are clearly more common in tenders by the large firms, compared to small- and middle-sized ones, and appears - from this material - more common in construction and oil, gas and power transmission than in other sectors.

*Summary: Procurement-related characteristics reported in the business survey*<sup>11</sup>

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*Large firms*

- are better able to influence tender specifications
- are more likely to suspect tender results to be pre-determined
- have a lower trust in procurement procedures' ability to prevent corruption
- are more likely to find the competition in their own industry 'biased'.
- more often believe that diplomatic pressure has an influence on the competition
- are more often asked for quid pro quos

*Firms with long experience from international markets:*

- are more likely to think that they have lost contracts because of corruption
  - say more frequently that they negotiate the contract all through the tender procedure
  - have more often obtained contracts in a way that needs to be kept confidential
  - are more likely to consider the business practices of their competitors 'unethical'
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These results emphasize the challenge of designing procurement procedures for large international tenders, like infrastructure contracts. The responses also suggest that common procurement procedures make a significantly better protection against corruption when the participating firms are small and medium sized.

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<sup>10</sup> The Bribe Payers Survey was conducted in 15 emerging market economies and included 831 interviews about perceptions of multinationals from 21 countries.

<sup>11</sup> These responses are significantly more common among firms with local production (FDI), compared to the total sample of respondents.

### 2.3 Firms' motivation behind tender manipulation

Increasing sales is the main motivating factor for the choice of any business strategy, unethical practices and corruption included. Given this main driving force, there are still differences in what firms seek to achieve with the help of bribery-resembling practices. This study gathered information from firms about the purposes behind corruption, and also about 'the underlying motivation behind the crime.'

Table 2 informs about the responses on suggested purposes for other firms in the respondent's industry to influence tender procedures unduly.

*Table 2: Suggested purposes behind bribery*

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Question: *'If companies in your line of business operate unduly, for instance by establishing secret ties to decision-makers, what would you suggest that they typically would be aiming at?'*

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Obtain the contract through direct negotiations	26%
Secret information about evaluation or tender specifications	19%
Secret information about the other companies' bids	15%
Adjustments in tender specifications	14%
Being part of a bid for a larger contract or concession	7%

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The respondents suggested that bribes are most often paid to obtain a contract through direct negotiations, which means the abandonment of tender procedures altogether. Common justifications for direct negotiations are the familiarity of operators with similar equipment, the uniformity of spare parts, a preference for previous suppliers, or the fact that a tender procedure would be too expensive or time consuming. Although these justifications can be legitimate, they may also facilitate corruption.

Note, however, despite their low confidence in the procurement procedures' ability to prevent corruption, the firms' interest in obtaining direct negotiations actually points at tender rules as a relevant anti-corruption instrument. There is no logic in offering bribes to avoid tender procedures if these rules are not functioning.

#### *Underlying motivation*

The respondents were asked to suggest the most important underlying motivation for companies in their line of business to take part in corruption. The question was based on Moody-Stuart's (1997:21) explanation of why companies pay bribes. The respondents were given three alternatives other than the obvious goal of getting a contract. On the basis of all responses, these alternatives were ranked as follows:

*Table 3: Suggested 'underlying motivation' behind bribery*

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Question: *'Considering the following alternatives, what would you suggest is the most important underlying motivation for companies in your line of business to offer bribes?'*

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The fear of losing contracts because someone else has bribed the decision-makers	43%
Because the goods or services would never be chosen in a fair competition	21%
To persuade decision-makers to buy goods or services that otherwise would not have been demanded	5%

The third alternative motivation behind bribery, persuading decision-makers to buy goods or services which they basically do not need, had a low rate of response (5%). The second alternative, goods that would not have been chosen in a fair competition, refers to products or services that are of poor quality or are overpriced. The buyer demands compensation, a bribe, for choosing the specific product because better alternatives exist. This motivation is probably quite common but still was suggested by only 21%. The alternative suggested most frequently, by more than half of those who responded, was the concern about losing contracts simply because someone else have bribed the decision-makers.

The most common perception about underlying motivations behind bribery is thus related to a lack of trust in competitors in the industry. This result reveals a considerable information problem, but also a challenge when it comes to the credibility of firms' internal controls and the measures they take against corruption.

#### **2.4 The strategies of those who unfairly lose contracts**

To get an indication of firms' attitude to tender manipulation, the survey asked about the responses of those who actually lose contracts because of such practice in their industry. This approach was based on an assumption that those who are not reacting against corruption are to some extent accepting it, or adjusting to it. When respondents were asked directly, their acceptance of corruption was low. Some respondents, about 6%, still tolerated or defended corruption if the contract was 'necessary to avoid insolvency' or 'if corrupt practice is common to get contracts.' Other respondents, 18%, found corruption acceptable 'if there is no other way of operating in the market.' The majority, 58%, found it to be never acceptable.

Nevertheless, the disapproval of corruption appeared to be challenged in the respondents' daily business life. Whereas a large share of the firms claimed to have lost contracts due to corruption (66%), only 5% would actively lodge an appeal to the customer or the tender authorities if encountering a competitor whom they suspected to be involved in bribery. One out of four, 26%, would seek a formal explanation from the client under such circumstances. Such an explanation is, however, a routine part of any formal tendering process, and a firm's request will not necessarily reflect an active response to corruption.

If formal complaints are ignored or rejected, only 13% would try to respond in alternative ways, for instance, through political channels, in branch fairs, or through journalists. As many as 45% say that they would prefer not to react by any means if they were in this situation. A majority of these firms agree with the statement that

‘corruption is part of the game.’ Among the persons who claim that corruption is never acceptable, 35% say that they prefer not to report or react against the practice. These responses question the reported intolerance of corruption. Many respondents seem to consider corruption a fact of life where their own reactions will have no more than a marginal impact. This assumption is supported by 65% who claim that they would have been more inclined to respond to this form of bribery if it took place in a country where corruption is perceived to be uncommon.

The survey results revealed a surprisingly weak propensity by firms to react on the tender procedure in cases where they considered themselves victimized because of corruption. If competitors pay bribes, the companies lose not only their fair chance of gaining the contract but also the cost of taking part in the tender, often a significant amount of time and, for large firms, it can amount to several million dollars. In spite of these losses, they prefer not to complain or claim for compensation.

The most plausible explanation is perhaps the lack of proof in these cases. It will often be impossible to verify that corruption has taken place, and there is, of course, a general reluctance to accuse somebody of being “corrupt” without clear evidence. However, firms that have participated in a tender where the outcome has most likely been affected by corruption will often have a justified suspicion. They may have been asked for bribes themselves, they pick up reliable rumors, or by other means they realize that the tender procedure is flawed. To explore this issue, the respondents were asked to rank alternative explanations. The result is summarized in Table 4.

*Table 4: Why not react against tender corruption?*

*Question: ‘Independently of the experiences of your own business unit, what do you think is the most common reason for a company to keep quiet when encountering a competitor in bribery?’*

Concern about future business cooperation	31%
Concern about sanctions from customers	18%
Lack of knowledge about the illegality of the act	15%
Lack of proof	12%
Concern about sanctions from the bribing company	5%
Concern about sanctions from other companies	5%

Many firms would reportedly not react against lost business because of a worry of losing future business cooperation. These responses reveal a significant caution among firms in their choice of response under such circumstances. They also reveal a strong hesitation among firms to act in the most responsible way, namely by reacting against corruption when uncovered or suspected.

### 3. Opportunities to manipulate infrastructure tenders

Large firms in construction, telecommunication or power transmission are usually oligopolists. They are able to obtain some profits, they are few, they know each other to a certain extent, and they are often in the same competition for contracts. In addition, they operate some form of public-private partnership, where contract or concessional terms on building and operation are key to long term revenues and market power. These features are relevant in understanding the motivations and opportunities to hide corruption and manipulate tenders in infrastructure industries.

The many opportunities to influence a tender through corruption can generally be grouped into the following two categories (Soreide, 2005).

- i) Hidden violations of procurement rules – it looks like as if the rules have been respected.
- ii) Legitimate deviations from procurement procedures – rules of exception are too frequently exploited.

These two categories will include most strategies and cases. In this setting, however, I wish to add another two categories that are particularly relevant in infrastructure projects and important channels of tender manipulation. These aspects, pointed at by the business survey, are:

- (iii) Diplomatic and political pressure.
- (iv) Lack of whistle-blower reactions against corruption.

Theoretically, the opportunities presented by these four categories are present in all industries. However, surveys like Transparency International's Bribe Payers Index (TI, 2002), their Corruption Barometer (TI, 2005), and PriceWaterhouseCoopers' Global Economic Crime Survey (PWC, 2005) all point to infrastructure projects as particularly prone to tender manipulation, results supported by the survey presented in this paper (Soreide, 2006a). In addition, studies provide empirical evidence for a connection between perceived levels of corruption and the composition of public spending. It appears to be relatively more spending on infrastructure in countries with higher perceived level of corruption (Tanzi and Davoodi, 1997).

#### 3.1 Hidden violations

##### *Large projects financed by public funds*

The size and complexity of infrastructure projects, like airports, power stations or highways, make it difficult to control the costs and to define costs overruns. Prices can be inflated with the size of bribes, and the expenses of bribery are not necessarily covered by the firms involved. The direct costs of corruption can easily be passed on to taxpayers, who also are victims of the indirect costs of corruption.<sup>12</sup>

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<sup>12</sup> See Stainsbury (2005) for an assessment of the foundations of corruption in the construction industry.

#### *Limited invitation, short-listing/pre-qualification*

Tender documents in infrastructure contracting are thick books! The contracts are complex with many details and clauses, regarding specifications in the work, but also identification and allocation of risks. The firm can hardly suggest prices without these details considered. One way of hiding corruption is thus to announce the tender very late, while only the briber is informed in time to work out the documents. Another way of hiding corruption is to specify the criteria for pre-qualification so that the strongest competitors are prevented from participation in the tender. Similarly, the criteria for awarding the contract can easily be adjusted to fit with the qualifications of one specific firm.

#### *Misuse of confidential information*

The business survey revealed a low respect for communication rules, and also that confidential information is considered a value worth bribing for. The complexity of infrastructure contracts is viewed to justify negotiations at all stages of the tender procedure, and the opportunities to influence the procedures are obvious. Treasured information includes tender criteria and competitors' prices, though other forms of information, like information about control mechanisms, can also be misused to cover corruption. Infrastructure work is often concealed during the process, for instance by concrete, and it is difficult to control the true standard of the material or technical solutions (Olken, 2005). A firm that knows the control mechanisms can misuse the situation, and choose low-cost solutions.

#### *Renegotiation of infrastructure concessions*

The role as builder and often operator of public services provides the firms with exclusive ties to the client government. The contracts may have been awarded through competitive bidding procedures. A common characteristic of these contracts, however, is an opportunity to renegotiate the terms after the contract has been awarded and the project has started. In a survey of Latin American concessions, Guasch (2004) finds that 46% of contracts awarded through competitive bidding have been renegotiated, compared to only 8% of contracts awarded through bilateral negotiations. Guasch explains this striking difference by referring to the many reasons why bilateral negotiations allow the operator to extract more favourable concession terms. The opportunity to alter the contract post tender obviously reduces the benefits of competitive bidding. It reduces thus the value of welfare considerations behind the contract, while increasing the opportunities for firms to increase profits. If bidders believe, or perhaps know, that renegotiation will be feasible, they will adjust their proposal accordingly. The formalities in the tender procedure appear satisfactory.

### **3.2 Legitimate deviations**

Another form of tender manipulation is to misuse various rules of exception in the tender procedures. Most infrastructure projects tend to be unique in some way, and there is always a reason to deviate from common rules. If not technical, the justification can

refer to the cost of delaying the project. There are several forms of such deviations, most importantly:

#### *Discretionary power*

The higher the degree of discretionary authority the more opportunities there are for corruption. Those with discretionary authority may recommend the qualities offered by a specific firm, the briber. A challenge for governments is to set the right balance: less discretion implies a need for more detailed regulation. A simplification of rules, however, implies more discretion.

#### *Justifications for bilateral negotiations*

Most tender procedures are open for bilateral negotiations under specific circumstances. These rules of exception can be misused to obtain preferential treatment and cover corruption. For instance, completion of the project can be described as too important to spend time on tender procedures. Another argument could be that the satisfaction with a previous supplier is strong, and this firm should be chosen for exclusive negotiations.<sup>13</sup>

#### *Unsolicited proposals*

Many infrastructure projects in developing countries have been initiated as unsolicited proposals by firms to the government (Hodges, 2003). The proposal may include many details of the project concept, like construction plans, maintenance, and financing plans. The company submitting the proposal will often claim exclusive negotiations, so that the tender rules are set aside all together. This claim is perhaps based on the fact that the firm has developed the total idea, its need to protect intellectual property rights, or cost efficiency. The procurement laws of many countries authorize bilateral negotiations under such conditions.

### **3.3 Diplomatic or political pressure**

#### *Terminology*

The terms ‘diplomatic pressure’ and ‘political pressure’ are often used in the same meaning. A more correct use is probably to let diplomatic pressure on procurement refer to the influence from the government of a foreign tender participant, aimed to persuade the host government to award the contract to this firm even if the option is not the best price/quality combination. As mentioned above, in Section 2.2, it can take many forms, like being part of arms deals, voting in international organizations or tied aid.

Political pressure, as a different form of influence, will refer to domestic political processes, for instance in the form of alternative welfare considerations, employment issues, district politics, etc. These considerations are part of a democratic system, but can also be misused to cover tender manipulation.

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<sup>13</sup>See Moody-Stuart (1997) for a discussion about similar mechanisms. See Della Porta and Vannucci (1999) for more detailed elaboration about mechanisms and cases. The arguments are also detailed in Soreide (2005).

Successful diplomatic and political pressure will cause deviation from the ultimate goal of competitive bidding, which is the best price/quality solution in the given project. This follows by logic, as the pressure would not have been 'required' if the procedure in any case would lead to the outcome desired by the pressure group. Diplomatic and political pressures are thus also called *misprocurement* since the results often are inferior solutions in terms of best value for money.

*Political influence on infrastructure tenders is 'accepted'*

Political pressure, as a form of misprocurement, is particularly relevant in infrastructure contracting. The size of the projects and the practical value of completion will often spur significant engagement. Political arguments related to infrastructure projects can gain substantial support in the population, although the consequence is tender manipulation and perhaps some form of misprocurement. There are always some political considerations available to defend the choice of a specific tenderer, like the importance of international competition on prices, the importance of protecting local industry, environmental considerations, etc.

Hence, independently of how the tender manipulation initially was motivated it can appear as part of a political and democratic game. Whether it is secretly triggered by local firms through bribery-resembling practices, by politicians who seek re-election, or by foreign tenderers and their governments, the outcome can easily be masked as a political decision - able to gain support from someone. As long as the misprocurement is presented in the form of a political argument it can be accepted by supporters (because they like the outcome) as well as opponents (because such results are part of the political and democratic processes). The mechanism is, however, a serious threat to the function of procurement procedures in infrastructure tendering.

*Industrial organization and firms' willingness to pay*

Another relevant mechanism in oligopolistic markets of large firms is the connection between firms' willingness to pay and their possibilities to gain market power (Bjorvatn and Soreide, 2005). Tenderers may differ in this respect, for instance because one of the tenderers is foreign while domestic competition is limited, or because one of the firms has ownership shares or cooperation with firms in upstream or downstream industries.

The revenues obtained by domestic authorities through privatization or concessioning will usually be higher the stronger the resulting market power of the selected firm. The firm's willingness to pay 'under the table' will similarly increase with the possibilities to gain large profits. Corrupt politicians can extract bribes during the contracting procedure, and also later obtain benefits to keep the firm with its exclusive position (Shleifer and Vishny, 1998). The political justification, made in public, refers to important state revenues. The resulting market power for the selected firm will, however, materialize as higher prices for a local population, i.e. a lower 'consumer surplus'.

### 3.4 No whistle-blowers

The last category of factors that make tender manipulation in infrastructure particularly easy relates to the culture of secrecy in these industries.

#### *Commercial confidentiality*

The high level of technology and complexity justifies concerns about commercial confidentiality in infrastructure industries. Stansbury (2005:38) concludes, however, that there is 'no culture of transparency' in the construction industry. Inspection does not occur according to the regulations, and information that is supposed to be published is kept confidential. There is not a culture of speaking out about questionable practices. 'We do not want to make any fuss' - in the words of one interviewee of this study. In addition, a PWC report on the construction industry finds construction companies to 'approach the problem of fraud in ways starkly different from companies in other, more highly regulated sectors' (PWC, 2004:1). The report finds that there is a clear tendency to overlook the problem rather than implementing monitoring systems.

#### *No responses to unfair awardance of contracts*

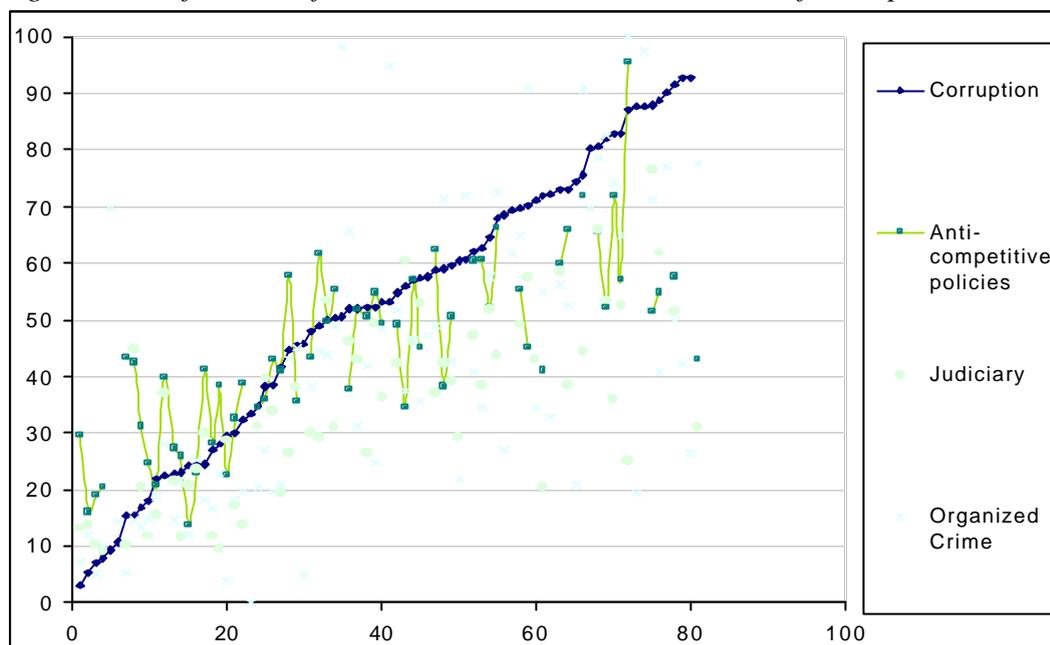
The reluctance to speak out about tender corruption can have strategic explanations too. The most frequent explanation in the business survey, discussed in section 2.4, was a 'concern about future business cooperation', while the concern about irritating the client was less important. And firms that never operate formally with other firms in the market were just as concerned about future business cooperation as those that frequently had such cooperation. Considering these results in the light of firms' opportunities to collude makes the reluctance to speak out look like a profitable decision. The choice appears as a weighing between: 'Better business climate if being a whistle-blower', on the one side, and 'cooperation with firms in the industry and cartel profits', on the other. A responsible attitude can leave the firm with lower profits. A whistle-blower reaction would make it less welcome in cartel cooperation, or it could even destroy opportunities for such profits for all the firms in the market.

This speculation is supported theoretically by Lambert and Sonin (2003) who describe the specific risk of collusion in procurement tenders. It is also supported empirically by a strong correlation between the function of antitrust institutions and reported problems related to corruption, as illustrated in Figure 2. The figure is based on my own estimates of data from the World Bank Business Environment Survey (Batra et al., 2003).

These survey data, on the function of antitrust institutions and the level of corruption, are the reported experiences of foreign and local business people in a large number of countries. The correlation is significant at the 1% level, with a correlation coefficient of 0.48. Data on the reported quality of the judiciary and the level of organized crime (from the same source) are included with weak colors. The correlation between these data and the reported levels of corruption is not as strong as the one between antitrust institutions and the levels of corruption. The correlation illustrated by Figure 2 points to

the general necessity of including antitrust institutions in general anti-corruption efforts.<sup>14</sup>

Figure 2: The function of antitrust institutions and the levels of corruption.



#### 4. Concluding remarks

This paper addresses challenges that we have been aware of for a while: Corruption is more common in infrastructure contracting than elsewhere, and more frequent the larger the involved firms. A recent business survey points at the enduring presence of a form of procurement practices that have been addressed for more than a decade: Contracts are pre-selected, tender criteria are influenced by the tenderers, firms consider the procedures biased and unfair, and rules of communication are not respected. Moreover, politicians intervene in the procurement procedures, either with good or dishonest motivations. Manipulation of tenders occurs when procedures in fact are in place and supposed to prevent such practice. It is therefore optimistic to believe that sound and internationally recognized procurement procedures represent efficient anti-corruption tools. Rules are important, but efficient only when combined with other efforts.

A major challenge in this respect is how to addressing political corruption. Opportunistically motivated interference in procurement procedures is difficult to attack legally. Often there are political arguments available for corrupt politicians that ‘legitimizes’ the selection of a certain tenderer in a specific project. The political intervention can appear benevolent, and the misprocurement can not be attacked legally on the basis of failures to improve local welfare. However, the various arguments

<sup>14</sup> See Soreide (2006c) for an analysis of the incentives for firms to stay silent while suspecting tender corruption.

applied to facilitate corruption will seldom justify an elimination of competitive mechanisms to determine the project developer.

In cases where political corruption is provable the problem should be brought to court when possible. The media tends to pay attention to cases where representatives of political elites are involved. One single court case, like the ELF scandal in France, can thus make a difference, also across borders.

The challenge is different in nature when political interventions in infrastructure contracting are motivated by benevolent concerns, like the protection of vulnerable ethnic groups, the labor forces, local industry or the environment. However, procurement should not be misused to achieve social goals. A tender is not the right arena for political questions. They should preferably be dealt with before the tender procedure starts, and not postponed as long as possible. Political intervention in the procurement procedures should thus be considered unacceptable, regardless of the motivations behind such interventions.

The impediments to sufficient inspection and monitoring of infrastructure projects underscore the importance of focusing on welfare indicators in the preparations and evaluation of infrastructure projects. There will usually be more benefits for corrupt politicians and high-ranking civil servants to be gained from the corruption when the firms involved are able to increase their profits. The firms' pressure for renegotiation of contractual terms will obviously also be stronger when it involves possibilities to increase profits. These profits will usually depend on higher prices for ordinary people and firms, and will often imply lower domestic welfare effects of the given project. Ex ante and ex post assessments of the project's poverty impact are important to direct attention towards the true value of the project for the local population (Cook et al., 2005).

However, the problems related to infrastructure procurement are not possible to combat by procurement authorities alone. While governments worldwide have reformed their procurement procedures in recent years, it is now up to the firms to recognize changes, stay professional, and not, for instance, assume that 'personal connections' are what really matters in the procedures. The incentives of firms to make profits are usually well pointed out by their shareholders. The motivation to obtain contracts is strong, and tendencies of firms to push their legal limits are expected. Nevertheless, the fact that firms have owners and internal incentive mechanisms does not release them from their wider responsibilities as actors in a society. The width of this responsibility has been much debated (Rose-Ackerman, 2004). Firms' direct influence on the business climate, through their own business behavior and their recognition of local and international legislation, is among the more obvious conclusions from these debates.

One way in which firms can act responsibly to improve the business culture in infrastructure industries is to raise their voice when misprocurement, fraud, corruption, or similar offenses actually take place. Firms should be guided on established complaint arrangements and trade tribunals. The survey revealed that firms are worried about

tattling on other firms in the market or irritating the client. These worries make it necessary to establish arrangements where firms are being compensated for their loss because of undue business practices. Appeal processes able to secure a victimized firm a compensation for wasted tender expenses, or even an opportunity for re-tender, are able to 'rationalize' the whistle-blower decision. A strategic reason to appeal may reduce the risk of being ostracized from the business community or 'irritating' potential clients. The risk of being detected by competitors, in addition to local authorities, can reduce the expected benefit of bribery.

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