

COSTS OF CORRUPTION IN PUBLIC ACQUISITION PROCESSES

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Abstract

Defining corruption is difficult due to the fact that it occurs in many forms and evolves continuously. In addition, the people involved are trying to hide their actions, which make the identification of corruption difficult.

Corruption distorts competition and may reduce the quality, sustainability and security of public acquisition projects and at the same time reduces the likelihood that purchased goods and services will genuinely meet public needs. The cost of corruption in public acquisition is measured not only through money lost from public financial resources. The direct costs of corruption derive from the incorrect and non-transparent allocation of public acquisition funds by setting either lower quantities of goods and works, or by overestimating the prices and the downstream tariffs in budget commitments and public spending, by violating of the principle of efficiency and accountability of the use of public funds, acts and economic facts that are in contrast to the real prices and tariffs of the competitive market.

Through the mechanisms used to support the private interests of legal entities in their capacity of presumptive public acquisition contractors / adjudicators, corrupt acts of public policy makers, including by exerting political influence on managers and authorizing officers of national or sub-national public authorities contracting parties are likely to increase the indirect costs of corruption in terms of distorting competition and hampering access to the public acquisition market for economic operators.

Key words: public acquisition, corruption, direct costs, public finances, public resources

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I. Introduction

The increasing need for public financial resources requires, together with increasing absorption indicators to adopt new methods of ensuring budgetary discipline at both Community and Member State level.

Corruption distorts competition and may reduce the quality, sustainability and security of public acquisition projects and at the same time reduces the likelihood that purchased goods and services will genuinely meet public needs. The cost of corruption in public acquisition is measured not only through lost money.

For the new 2014-2020 budget framework, Romania received, as all other Member States, higher Structural and Cohesion Fund allocations compared to the 2007-2013 programming period, e.g. € 22.88 billion versus € 19.06 billion. These allocations are also adequately reflected in per capita allocations (€ 1,150.85 per capita versus € 959.18 per capita).

The start of the new 2014-2020 budget framework was marked by major difficulties including in Romania, which did not understand, on the one hand, to transpose the three European directives in the field of public acquisition within the deadline set by the European Union and, on the other hand, the Partnership Agreement drafted and submitted by the European Commission, concerning the new budget framework only after two revisions to it, imposed by the European Commission itself.

The direct costs of corruption include the loss of public funds through higher, incorrectly allocated and low quality goods, services and works (OECD, 2016, p.7). Those who pay bribes seek to recover their money by increasing prices by billing for unpaid labor through products and services that do not meet contract standards, reduce work quality or lower materials for public works. This leads to excessive costs and a decrease in quality.

II. Methodology

2.1 Financial and economic costs of corruption

Few government activities create greater temptation or offer more opportunities for corruption than public acquisition. Thus, it is estimated that about US \$ 2 trillion annually disappear from public acquisition budgets, so there are few examples of greater damage to the public and thus harm public

interests to a greater extent than corruption. (Transparency International 2014, p.8).

Good public acquisition should meet public needs, secure money for people, and be fair to bidders. Corruption distorts competition and may reduce the quality, sustainability and security of public acquisition projects and at the same time reduces the likelihood that purchased goods and services will genuinely meet public needs.

The cost of corruption in public acquisition is measured not only through lost money. Corruption influences the process of public acquisition and diverts funds away from social needs, raises bad decisions, distorts markets and competition, raises prices and costs, and increases the likelihood that services and goods will be of poor quality that could put environmental sustainability and human life in danger. (Transparency International 2014, p.8).

Thus, the adverse effects of corruption according to Transparency International (2014, p.9, 10) are:

The financial impact can be represented by:

- The high cost of purchases, investments, services or income diminished from licenses, permits and concessions.
- The poor quality of goods or works does not justify the price paid.
- The government is burdened with financial obligations for acquisitions or investments that are oversized and are not necessary or economically justifiable.
- Governments are forced to hire resources for necessary repairs due to inappropriate construction of roads or buildings.

Erosion of value and trust in government

- Corrupt behavior of government officials or tolerance of corrupt behavior encourages bad practices by companies and citizens.
- Lack of integrity in public acquisition decreases the validity of governmental decisions in other areas and diminishes confidence in another government.

For the 2007-2013 financial years, Romania has been allocated Structural and Cohesion Funds in the amount of € 19.06 billion, plus direct payments under the Common Agricultural Policy of the EU for € 13.8 billion.

Table no. 1.

Absorption of structural funds in Romania compared to other EU Member States

Country	Total allocations 2007-2013 (Billion EUR)	Total allocations 2014-2020 (Billion EUR)	European cumulative payments 2015	Absorption rate 2015 %	Total allocations / Resident 2013 (EUR)	Total allocations / Resident 2014-2020 (EUR)	Total Payments / resident 2015 (EUR)
Bulgaria	6,6	7,55	5,62	85,20%	916,08	1.048,26	780,50
Croatia	0,86	8,56	0,50	58,60%	203,03	2.026,73	118,98
Estonia	3,40	3,58	3,23	95,00%	2.591,59	2.725,78	2.462,01
Latvia	4,53	4,51	4,30	95,00%	2.281,08	2.271,70	2.167,03
Lithuania	6,78	6,77	6,44	95,00%	2.319,37	2.319,13	2.203,40
Poland	67,16	77,43	63,73	94,90	1.767,11	2.037,36	1.676,99
Czech Republic	25,82	21,98	21,86	84,70%	2.449,95	2.086,00	2.075,10
Romania	19,06	22,88	13,32	69,90%	959,18	1.150,85	670,47
Slovakia	11,49	13,99	9,8	85,30%	2.118,67	2.579,74	1.807,22
Slovenia	4,1	3,07	3,9	95,00%	1.988,03	1.490,53	1.888,63

Source: own processing based on data from the Annual Reports of the Romanian Tax Council

Attracting European Structural and Cohesion Funds through the various Operational Programs under the 2007-2013 budget of € 13.32 billion, alongside the € 13.8 billion of direct payments under the European Union Common Agricultural Policy, has led to direct support for sustainability Romania's public finances with a contribution of € 27.12 billion in European Funds attracted by Romania in 2007-2015.

Compared to other new EU Member States, according to EC data, the absorption rate in Romania remains the lowest, being only 69.9% in 2015 (74.80% in May 2016), excluding Croatia that joined the EU in 2013 (with an absorption rate of 58.6%). All other new EU Member States have absorption rates between 87.7 % (Czech Republic) and 95% (Estonia, Latvia).

Since 2014, the EC has highlighted several factors that have contributed to maintaining the lowest absorption rate of European Funds in Romania, drawing attention to the fact that they may have a negative impact on the preparations for the new generation of programs and on their implementation:

- Insufficient administrative capacity to manage Programs and Projects;

- Poor coordination between the relevant ministries, the Sectoral Policy Makers and the institutions responsible for managing the funds;

- The precariousness of management and control systems and practices in public acquisition.

The start of the new 2014-2020 budget framework was marked by major difficulties including in Romania, which did not understand, on the one hand, to transpose the three European directives in the field of public acquisition within the deadline set by the European Union and, on the other hand, the Partnership Agreement drafted and submitted by the European Commission, concerning the new budget framework only after two revisions to it, imposed by the European Commission itself.

Against this background, the lack of accountability at the level of the public decision makers regarding the establishment of the national strategic framework for development policies and the implementation of the European norms in the area of access and efficient use of European funds, Romania still risks blockages in the primary stage of the budget framework for operational programs agreed with the European Commission mainly due to:

- Lack of clear and effective legal rules, simple and clear financing guidelines;

- Lack of political will expressed in an unsustainable way through public policies promoted, while Romania does not have strong political institutions to implement responsibly the effective public policies with the consequence of increasing the absorption of European funds;

- The lack of strategic vision on Romania's development strategy over the next 5 years, as evidenced by the incapacity and position of Government members both in the process of negotiating and adopting the Romanian Partnership Agreement with the European Union and in terms of the level of budget allocations per capita through the Structural and Cohesion Funds within the 2014-2020 budget;

- Insufficient support for institutions to fight corruption and fraud by public and political decision-makers, by providing mechanisms and systems for detecting and combating corruption and fraud from public funds and especially from European funds;

- Under-dimensional and poor regulation of the competence and responsibility of the force structures to combat corruption and the conflict of interest in public acquisitions and the sub-dimensional capacity of the DNA structure, DLAF, AA, ANI, ANAP, etc., thus viewed as an interconnected

system which cannot effectively control public money leakage through corruption and fraud;

- The non-unitary application of the European Union's criminal policy in the area of accountability for corruption and fraud in European funds continues to be developed both at the level of Romania and at the level of other states with consolidated democracies (Germany, France, Austria, etc.), the public perception that the dual language of European officials on the fight against corruption by ensuring a common criminal policy is likely to reduce the involvement of civil society in detecting and reporting corruption as long as the fight against corruption is only a common theme of explaining impotence and the inability of the administration of each state and of Romania in particular to justify its poor performance and lack of macroeconomic results.

2.2 Direct costs associated with corruption in public acquisitions

The direct costs of corruption include the loss of public funds through higher, incorrectly allocated and low quality goods, services and works (OECD, 2016, p.7). Those who pay bribes seek to recover their money by raising prices by billing for unpaid work through products and services that do not meet contract standards, reduce work quality, or use inferior materials for public works. This leads to excessive costs and a decrease in quality.

A study by the OECD and the World Bank shows that the phenomenon of corruption in the infrastructure and extraction sectors leads to misallocation of public funds and services that do not meet the standards. (OECD, 2016, p.7).

Although it is difficult to measure the exact cost of corruption due to its hidden nature, it has been estimated that between 10-30% of investment in publicly funded construction projects may be lost through poor management and corruption and are widespread estimates of 20-30% of the value of a project are lost through corruption (OECD 2016, p7).

Within the European Union, the cost of general corruption is estimated at € 120 billion per year (European Commission, 2014a), which represents about 1% of EU GDP and which was slightly lower than the EU's 2014 annual budget, which amounted to € 143 billion (European Commission, 2014b). (OECD, 2016, p.7)

The **direct costs of corruption** derive from the incorrect and non-transparent allocation of public acquisition funds by setting either lower quantities of goods and works, or by overestimating the prices and the downstream tariffs in budget commitments and public spending, by violating the principle of efficiency and accountability of the use of public funds, acts and economic facts that are in contrast to the real prices and tariffs of the competitive market.

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What is worrying in the anti-corruption fight is the lack of mechanisms to prevent corruption phenomena at the level of the contracting authorities as well as the lack of measures for public awareness of the effects of corruption in the misappropriation of public funds.

Corruption generates direct public losses from the budgets of institutions and contracting public entities, but in the long run they bring costs of inefficiency in the use of public funds, which are difficult to quantify and address both economic, environmental, social issues, but also the ability of the administration to contribute through policies to improve the business environment and the sustainability of the public acquisition system.

European funds are affordable and easy to tackle in particular for staff training projects, mainly due to financial conditions and project management that concern the non-patrimonial component of human abilities.

By means of national funding through the POSDRU program, an Operational Program designed to develop the personal capacities of individuals, tangible assets or evaluable patrimonial values were not materially materialized, and therefore the effects of personal development programs cannot be assessed in monetary terms according to international norms on the assessment, which makes the estimation of corruption and fraud in funds for personal development very limited.

The study entitled “Identifying and Reducing Corruption in Public Procurement in the EU” of PwC EU Services, 2013, distinguishes four categories of causes in public acquisitions in the context of corruption:

- Cases of corruption with a final judgment or a confession certified by one of the parties involved,
- Cases with strong clues to be "corrupt",
- Gray area cases with weaker indications of being corrupted,
- Clean cases with no indication of being "corrupted." (PwC EU, 2013, p.13)

During the study, four main types of corrupt practices were identified from the 96 corrupt / gray area cases analyzed, namely:

- Manipulation of tenders: the contract is "promised" to a contractor, with or without the consent of the public servant.
- Bribes: Public officials' requests that a bribe will be considered in the auction process, including in administrative processes.
- Conflict of interests: the civil servant has personal interests in the winning company.
- Others - including misguided / ignorant management: the civil servant did not properly perform the checks or follow the procedures if necessary or tolerates poor management by a contractor.

Generally speaking, the study estimates that the amount of faked auctions is found in almost half (48%) of practices and most present in water and waste projects and R & D projects. Falsification of auctions is more common in Hungary, Poland, Lithuania and Italy. Bribes are the most common form of corruption in Spain and Romania. Conflict of interest was encountered around 20% of cases and in all sectors, albeit a little more frequent in vocational training and the urban / communal construction sector. Deliberate malicious management was found on average in 4% of all practices.

2.3 Impact of corruption on the economy

Over time, there has been a significant international focus on corruption as a threat to economic and human development. There are many international organizations such as the UN, World Bank, WTO, OECD and GRECO to fight corruption. Until now, however, the strategies to turn the alleged corrupt government practices into honest and clean, have failed in most cases.

There are several ways that this corruption persists, and the time it takes to reduce the problem can be one of the factors. There may also be a

failure to adjust anti-corruption strategies to local conditions. At the same time, the incentives to implement the necessary measures can make poorer politicians benefit from the current system. (Soreide T., 2002).

However, in countries where corruption is a common problem, it tends to disturb market mechanisms and hinder economic development. Corruption in public acquisition makes officials or politicians buy goods or services from the best bribers, instead of choosing the best value-for-money combination. (Soreide T., 2002)

The result may be in construction projects often more expensive than necessary, or the purchase of goods that are not actually needed.

There is an ambiguous relationship between corruption and economic development. Some researchers have argued that corruption can be a good thing, because it can smooth rigid bureaucratic systems. There is indeed some truth in this, because excessive bureaucracy can make unprofitable businesses and impossible entrepreneurship (Amundsen, I. 1999). Corruption can scrape the wheel that squeaks into state bureaucracy, unlock doors, and allows the private entrepreneur to promote his business.

From an economic point of view, corruption is not always bad. This is seen, for example, in the level of economic growth and the level of foreign direct investment in large corrupt nations. In some countries the growth rate does not seem to suffer, as it has been maintained at a high level for years despite the existence of systemic corruption. This is mainly in the case of some countries in South-East Asia. (Amundsen, I. 1999).

The general notion, supported by many empirical data, is that corruption is detrimental to economic development because it is detrimental to foreign investment and foreign aid, local private investment, taxation and entrepreneurship, etc. (Amundsen, I. 1999). The economic effects of corruption depend on the type of corruption in each country and on how corruption is organized or disorganized and evaluated as such by national institutions.

In general terms, the difference is between controlled and uncontrolled corruption, and thus between calculable and unpredictable corruption.

Smarzynska, B. K. & Wei, S-J (2002) shows how a foreign investor's decision to achieve FDI and to choose how to enter a host country is affected by the scale of corruption in that country. The cost of the business is influenced by local and less bureaucratic corruption. At the same time, corruption affects the decision to set up a joint venture with a local partner. On

the other hand, foreign investors with sophisticated technology can worry with respect to technological leakage or abusive use by local partners and are thus less inclined to form a joint venture.

III. Conclusions and recommendations

The interventions and the influence exercised by acts of corruption of public decision-makers in the preferential awarding of public acquisition contracts to economic operators who agree and accept the payment of considerable sums from the value of the contracts of about 10-30% of the net value paid by the contracting authority is a reality which largely explains a general appreciation we can make regarding the inefficiency of using public financial resources and the direct link between the efficiency of public funds use and the phenomenon of systemic corruption.

Euro-zone countries have a system of financial support and financial assistance through the European Stability Mechanism (ESM), while non-euro states do not enjoy the same treatment from the European Council and the European Commission, which still create the conditions of widening discrepancies and disparities between Member States.

The low level of absorption of European Funds in Romania is also explained by the numerous blockages of European Programs, due in particular to the significant irregularities in the implementation of the Operational Programs detected by the European Commission through the use of fraud detection systems and mechanisms in European Funds, thus attracting Romania's blockages of the European funding programs, mainly due to the weak operational capacity of the managing authorities and the insufficient regulation of the European funds absorption field.

Corruption is manifested in all stages of the public acquisition cycle both for small projects (under € 1 million) and for large projects favoring corruption, but the most significant losses are in the training projects, as also results from the performance reports DNA and DLAF at national level, data indicating a factual predicament, respectively, in the projects financed under the POSDRU Operational Program, with the most cases of irregularities and frauds from European Funds.

The possibilities of detecting fraud and estimating losses from corruption are different depending on the nature of the projects financed, by

way of example, considering that research development projects are more difficult to assess in terms of quantifying the efficiency losses and the direct costs of corruption, with both at European level and at national level there are no bodies for the assessment of intellectual creation and scientific creation in general, which will maintain a state of uncertainty in assessing fraud in scientific research projects at the level of the European Union as well as at national level.

The interventions and the influence exercised by acts of corruption of public decision-makers in the preferential awarding of public acquisition contracts to economic operators who agree and accept the payment of considerable sums from the value of the contracts of about 10-30% of the net value paid by the contracting authority is a reality which largely explains a general appreciation we can make regarding the inefficiency of using public financial resources and the direct link between the efficiency of public funds use and the phenomenon of systemic corruption.

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