ANTI-CORRUPTION IN PUBLIC PROCUREMENT

BALANCING THE POLICIES
This paper analyzes the mechanisms of corruption in public procurement in the context of the EU policies in this area. The analysis focuses on the implications of governance failures in procurement as experienced in two countries of quite different corruption propensities – Norway and Bulgaria – for the European anti-corruption and public procurement policies. The paper intends to inform the development of the expected EU policy updates in these areas by analyzing the trade-offs that are necessitated when combining competition and anti-corruption goals.

The paper was written by Dr. Jens Andvig, Research Professor, Department of International Economics, Norwegian Institute of International Affairs with contributions (section 1.1) by Boyko Todorov, Senior Fellow, Center for the Study of Democracy.

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Editorial Board:
Dr. Ognian Shentov
Boyko Todorov
Dr. Maria Yordanova


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5 Alexander Zhendov Str., Sofia 1113
tel.: (+359 2) 971 3000
fax: (+359 2) 971 2233
www.csd.bg, csd@online.bg
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SUMMARY

With the growth of central and local public institutions in modern industrialized countries, public procurement has become a significant macroeconomic variable. The EU strategies for economic development associate a number of expectations with government purchasing. Specific Union legislation in this field has been around for over 40 years but has only fairly recently included an anti-corruption provision per se – banning companies convicted of corruption in bidding for public contracts. Current policy deliberations, which should lead to a “modernization” of EU procurement rules by 2012, are inconclusive about possible expansion of corruption provisions. A major challenge to be tackled in this respect is the compatibility of anti-corruption policies with other considerations, such as compliance costs, administrative burdens, and, crucially, with the promotion of competition.

Being a highly sensitive issue among governments, corruption is not an easy subject for common policies. As a result, both the level of corruption and the impact of the anti-corruption policies are still being evaluated either though statutory reviews or surveys of perceptions. While other policy areas are being scrutinized through a range of measurement indicators, corruption is still the domain of unreliable assessments. To overcome this and allow anti-corruption to become as evidence based as other EU policies, the EU should develop its own facility for measuring corruption. This would allow it, among other things, to avoid having to catch up with corruption developments and to carry out risk assessments, especially in government contracting. The Bulgarian experience with diagnosing corruption, based on the Corruption Monitoring System of the Center for the Study of Democracy, is particularly relevant to the development of a future EU-wide mechanism, especially because it took place in the context of EU accession.

The impact of policies depends on their delivery mechanism. A change of governance principles and management culture in government administrations in industrialized countries is having an impact on corruption propensities, in addition to any effects that policies may have. An increasing reliance on project-based organization in public administrations may enhance efficiency but creates its own corruption risks different from traditional bureaucracy. Crucially, this shift allows a wider role for its procurement of private sector services. It implies that the accomplishment of tasks formerly done inside a given public organization would now require the involvement of several organizations, both private and public, whose coordination involves joint private-public task sharing, but also a disbursement of public sector funds to private enterprises. This new management culture creates divided loyalties thus potentially stimulating corruption. In addition, the growing use of consultants in public administration implies ipso facto increased public procurement – in order to comply with regulations a large number of tenders have to be arranged.
In order to illustrate the choices and challenges for the European anti-corruption and public procurement policies the paper examines the implications of the experience with governance failures in procurement in two countries of quite different corruption propensities – Norway and Bulgaria. The experience with defense and oil industry procurement in Norway exemplifies how the modernization and downsizing of a government bureaucracy could expose it to corruption risks by creating a patchwork of different organizations or work units.

Bidding rules, including at the EU level, are intended to introduce a number of good governance standards but by doing so they also pose a number of policy dilemmas. Much too often policy design economizes analytical effort thus founding solutions on untested assumptions. Policy making truly concerned with actual impact needs to outline trade-offs and acknowledge an underlying and rarely avoidable ambivalence of policy. The existence of a number of variations implies that it is too simple to assume that governance failures are sort of cumulative – one problem only exacerbates another – and, conversely, governance advances are always unqualified. Adopting such assumption is tempting in policy making because it allows politicians to propose clear-cut solutions where none exist.

For example, by examining a number of cases of corruption in public procurement the paper shows that with a lot of public information contained in the bids, corruption becomes more difficult, while the cartel monitoring by enterprises is eased. Regulations intended to increase the complexity of arranging corrupt deals could make it easier for cartels to survive by increasing the entry costs to the competition. Thus, bidding principles that may fight corruption may stimulate cartel-making or industrial espionage. Ideally, a tender should be only arranged if the costs for arranging it are lower than the expenditures saved through a lower price. Most national procurement legislation, as well as that of the EU, is too rigid to allow bidding costs to have this kind of impact.

A key question for the updating of the EU procurement policies is what effect the increased cross-border competition for government contracts – assuming that it happens – would have on the allocation of corruption propensities: would there be a leveling towards higher or lower average corruption rates, or a still wider gap in the incidence of corruption among member states? In general, the short-term effects of increased internationalization of bidding for public procurement are likely to be in decreased prices, while the longer-term effects may be more uncertain. The main point is to stress that simple market analysis – which assumes that competition enhances integrity by default – will not do when dealing with the interaction between complex bureaucratic entities restrained by a set of complicated bidding rules.
INTRODUCTION

With the growth of central and local public institutions in modern industrialized countries, public procurement has become a significant macroeconomic variable. Today, it constitutes somewhere between ten and twenty percent of the GDP in most European and OECD countries. Even more importantly, from an economic perspective the accumulation of decades of public procurement decisions has determined the structure of public capital today.

Most of the current procedures applied in public procurement have been used more or less systematically for at least a hundred and fifty years. Nevertheless, until recently, public procurement had rarely been perceived as an important policy concern, nor had it been an important field of social science research. It was, instead, the domain of legal experts and public auditors. It could be that the microeconomics of public purchasing and contracting had been too heterogeneous and too specific in the actual items purchased to warrant any general analysis. This erstwhile perception of public procurement as a political and research non-issue has changed dramatically during the last two decades for a number of reasons:

- In economics, the study of auctions through game theory has created a common intellectual framework that explains a large number of public procurement issues.
- The EU has developed a legal framework allowing international access to bidding in public procurement.
- The social and economic significance of public procurement and its regulation has increased due to a shift toward project-based management in both the private and public sectors.
- Increasing concern for public governance issues in general and corruption in particular has turned into increased concern for the governance of public procurement activities where corruption risks are exceptionally high.

Not only has public procurement grown in scope and size, but it has also become ritualized in a number of bidding procedures that are also applied to the sale of public assets. Gradually, the competitive tendering principles have spread to other social areas: from social science research and the building of railways or airports, to waste disposal; from selling air waves or snow removal to public administration. In other words, public procurement principles are applied to nearly every activity priced above a certain threshold – which varies significantly among countries – and is paid by a public institution.

1 OECD (2009: 111).
2 Questions of the macroeconomics of public expenditures, on the other hand, (e.g. whether increases in public expenditures, of which procurement constitutes a large share, stimulate or contract the private economy) have received considerable attention since the evolution of Keynesian economics and its debates.
The main political force behind the expansion in using private suppliers of public services through auctions, as well as the drive for using auctions in regular public procurement in Europe have been the EU institutions. This tendency is also partly attributable to a general shift towards increased skepticism in the efficiency of public apparatuses and a growing belief in the efficiency of market-like institutions and market competition.

Sometimes public procurement is discussed as a separate market. This is, of course, only a metaphor – no general market for public procurement exists but only bidding systems introduced to a wide range of goods and services with their own market characteristics. For most areas of activity, public organizations represent a small share of the market actors. In the few cases where public organizations are the sole demanders, allowing international bidding may correctly open up a public procurement market. In general, the effects of having public organizations act under the restraints of the EU bidding rules would differ widely according to the characteristics of the specific sector.

Bidding rules are intended to introduce a number of good governance standards but by doing so they also pose a number of policy dilemmas. Among the key governance issues to be tackled is corruption. Though anti-corruption is a relevant consideration for any kind of public purchase, this paper will examine the potential for corruption in competitive tenders, particularly in relation to the procurement of large construction projects. A lot of the intricacies of bidding will be illustrated through examples from the Norwegian oil industry. The development of price cartels among suppliers will be added to the discussion in order to illustrate and explore the governance trade-offs that emerge between competition and anti-corruption considerations in public procurement policies. Since most policy-related studies of the introduction of bidding rules in public procurement have emphasized the potential welfare-enhancing effects of these forms of competition, this paper will emphasize their more problematic aspects, one of which is corruption. This would not entail, however, considering all bidding for public procurement contracts as pure rent-seeking games, even though there are cases when the costs of bid formulations may resemble the waste costs in rent-seeking. Neither would the closest alternative to competitive public procurement – the case where the procuring public organization produces the goods or services itself – be examined here.

Whether bidding systems in public procurement – and in particular whether opening them to international participation – are capable of

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3 While tenders (understood as written offers to contract goods or services at a specified cost or rate) are the typical method in procurement by governments and other contracting authorities, “auction” is also used throughout this paper to mean not necessarily a public sale in which property, items of merchandise, licenses, etc., are sold to the highest bidder but rather as it is applied in economics, where it may refer to any mechanism or set of trading rules for exchange.

4 In such case the bribing risks will be smaller while embezzling risks may remain. The major reason for the reduced corruption risks is that internal transactions between two different offices in the same organization will be mostly recorded in book-keeping money that cannot be spent outside the organization and used for private consumption (Andvig, 2006).
producing wider social benefits (e.g. by mitigating severe unemployment, reducing CO₂ emissions, protecting human rights, etc.) or disadvantages (e.g. stifle innovation through the mechanical and rigid application of rules or cause social dumping) is an issue of additional debate. Whether significant institutional changes in the interaction between the private and the public sector work in desirable directions is doubtful but the further exploration of this point is beyond the scope of this paper. While its focus is on economic governance, the paper also attempts to frame public procurement in a broader context of social changes that significantly impact the daily life of a large fraction of the European populations.

The approach adopted here is to examine the implications of the experience with governance failures in procurement in two countries of quite different corruption propensities – Norway and Bulgaria – for the European anti-corruption and public procurement policies. Thus, Part I of the paper looks into the developments and prospects of these policies. The EU intends to propose changes to its public procurement rules by 2012 and has published a Green Paper with ideas for simplifying and updating the existing regulations. In addition, the European Commission is planning to publish in 2011 an anti-corruption package containing “a comprehensive EU anti-corruption policy” and an implementation report of the Framework Decision on corruption in the private sector. In these and other policy areas the EU pursues a number of objectives that are not always complementary and at times not even compatible. This paper intends to inform the process of development of these policy updates by analyzing the trade-offs that are necessitated when combining competition and anti-corruption goals.

In order to facilitate the understanding of policies against actual experiences, Part II of the paper summarizes research into public procurement practices in Norway and Bulgaria. For Norway, the paper illustrates how the attempts to shrink the core of public organizations have changed the role of public procurement and argues that this has necessitated adaptations to increased job insecurity for agents working at the interfaces between the private and public sector.

Before outlining some recurring bidding issues in public procurement evident in the semi-public oil industry in Norway, the paper will provide a broad picture of public procurement in the country. Since the topic has been rather neglected in public debates, the paper puts together information from a diverse set of sources. A number of cases of misgovernance that have been fairly well documented by the media, and which illustrate the general governance issues involved, are sampled.

Although public procurement together with zoning regulation are the economic arenas with the highest corruption risks in Norway, corruption

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1 Suffice it to mention here that it can be hardly disputed that these changes have had important effects on the distribution of income and tasks across professions and other social groupings.

2 For the most part, the paper relies on secondary sources. Yet at times, it seeks to clarify some confusion that may easily arise when using the official statistics.
in procurement is still rather rare compared to Bulgaria. In general, the speed and scope of Norwegian developments dwindles in comparison with developments in Bulgaria. The changes in this new EU member state have been both more rapid and more extensive since the public sector at the outset included a much larger part of the economy. The social and economic costs imposed by the Bulgarian transition with its many chaotic features may give some returns, however, in the sense that the country may be better prepared for the *ad interim* nature of most public asset management structures currently in vogue in European countries and the US (the effects of project-based governance are examined initially in section 1.2).

Finally, a theoretical model which attempts to estimate the impact of cross-border participation in procurement tenders – as encouraged by EU regulations – on the allocation of corruption propensities among member states will be examined. **What is likely to happen to public procurement in countries with different corruption characteristics when international bidding becomes obligatory and no national preference is allowed? Would the gap in the incidence of corruption narrow or open further?** These are all questions to which a credible impact assessment of intended changes in anti-corruption and public procurement policies in the EU – and broadly the European Economic Area – needs to provide answers.
Public procurement is increasingly associated with great expectations. The 2020 Strategy of the European Union invokes it in the achievement of objectives ranging from improving framework conditions for business to innovate to a shift towards a low-carbon economy, while at the same time ensuring the most efficient use of public funds. In times of bulging public deficits, the effect of potential savings — expected to come from better procurement rules — on the public sector balance is eagerly anticipated. The growing hopes that government purchasing would continue to contribute to economic prosperity, as well as to a host of other goals, however, require that its regulation be constantly modernized and brought in line with economic realities.

A number of obstacles need to be overcome if public purchasing is to achieve such overarching societal goals; a fairly intractable one among these has been corruption. While it has been a major concern in public procurement in national contexts for some time, as a policy issue in EU procurement policy it is rather recent. In order to understand its ascent in the policy agenda, an outline of the background of EU’s anti-corruption policies is needed.

1.1. EU’s Anti-Corruption Policy

In the EU, corruption has been on the agenda since the mid-1990s. Although the focus on it has been sharpened by the two latest waves of enlargement, its effects have been identified across the Union to the extent that the European Commission concludes that “within the EU there is no corruption free-zone.”

Given its controversial nature, corruption has taken some time to move up on the EU agenda. The first call for action was in 1997, followed by a 2003 Commission Communication on “a comprehensive anti-corruption policy.” The latter was, however, an assortment of more or less general intentions, rather than a coherent policy document informed by a vision of what the EU role in this area should be. Its follow-up has been almost eight years in the making now, with an updated version announced for 2011. Of particular significance for anti-corruption efforts in public procurement is the 2003 Framework Decision on combating corruption in the private sector since it introduced criminal liabilities for legal persons.

7 European Commission, 2010a: 12 – 16.
which is crucial for the debarment provisions of the EU procurement legislation, a policy that will be discussed throughout this paper. The 2007 report on its implementation showed disappointing progress in the transposition of the Decision provisions into member state laws. It is impossible to tell, however, whether the Decision has had any impact on actual levels of corruption since these evaluation reports are only a type of statutory audit summarizing responses from member states.

The policy of the European Union on anti-corruption faces a challenge that is shared with all other international institutions aiming to be relevant in this field, namely the complexity of the drivers of corruption in various environments. Cause vs. symptom of underdevelopment, deliberate crime or rational behavior in adverse circumstances are examples of on-going debates in both academia and policy circles. For some time, the difficulty of publicly acknowledging the significance of the wide variation in corruption prevalence among countries had been an obstacle to attempts to agree on multilateral anti-corruption policies. This is gradually changing: in an uncharacteristically frank acknowledgement, the European Commission recently said that “solutions depend on the – widely diverging – national administrative and business cultures.” The scenarios of the impact of facilitated cross-border access to public procurement contracts across the Union on the gap in corruption rates among member states are considered in section 2.7 below.

While generally in the EU – and in particular during the process of the last two enlargements as well as the current scrutiny of some new members by the Commission (known euphemistically as the Cooperation and Verification Mechanism) – corruption has been seen as a matter of criminal justice and approximating laws, other international institutions (the World Bank, UNDP, most bilateral donors) have traditionally seen it as a developmental challenge. In the latter case it would be a matter of deficiency of certain social and economic institutions and laws rather than simply deviant behavior subject to prosecution by the state authorities. The difference is not academic but has rather shaped policies, laws, assistance and the collateral political pressure that went with it.

Seeing corruption exclusively through the prism of criminality could prove problematic for the EU since criminal justice is the least harmonized area in the Union and there is little enthusiasm for changing that. The criminal law approach has particularly been highlighted in the case of political corruption but the high stakes and complexity of political corruption make effective prosecutions exceptionally difficult. Graft among elected officials is more indicative of a deficient democratic process rather than ineffective law enforcement. Judging by the current rules and the pronouncements on policy plans at the EU level corruption in public procurement would also likely remain within the domain of criminal justice.

12 The question why criminal justice has proven so intractable to sovereignty-pooling efforts in the EU has received surprisingly insufficient research attention.
Regrettably, the congruity of approaching corruption from both the points of view of law enforcement and economics has not been a matter of debate in either research or policy documents. Enforcing criminal laws against bribery and introducing incentives to attract individuals and companies into the legal economy are not necessarily incompatible policies. This kind of complementarity, however, is rarely acknowledged even when it is achieved, mostly by accident rather than design. Ideally, it should involve a joint initial assessment by all stakeholders identifying the sectors where corruption is best reduced through various economic and social policies vs. corruption crimes against which law enforcement is most effective. The complexities involved in public procurement and its proximity to the political level make it unlikely that it would be amenable to the latter approach.

1.1.2. Anti-Corruption in Public Procurement Legislation

In the European Union, efforts to allow free and equitable access of suppliers to contracts awarded by public authorities across the Union date back almost fifty years. The so called General Programmes of 1962 set out to abolish rules and practices for the award of public contracts which discriminated against foreign undertakings on nationality grounds.\(^{13}\) In the intervening years, four “generations” of legislative acts have elaborated the rules seeking to ensure an open procurement market and have discriminated a number of objectives to be pursued at the Union level.

Development of the legislation has been seen as both cause and consequence of enhanced activity in this market. Contracts advertised EU-wide had increased two and a half times since 1995 to reach 150,000 in 2009, for an amount equal to 3.11% of EU GDP.\(^{14}\) Still, in 2004, at the time the latest Directives\(^{15}\) were being elaborated, direct cross-border procurement accounted for just 3% of the total number of bids submitted by the firms.\(^{16}\) The effect of the encouragement may not have been as expected: seven years later the Commission again acknowledges that “cross border-participation in EU public procurement procedures remains low,” with only 1.6% of public contracts awarded to operators from other member states.\(^{17}\)

In early 2011, the European Commission launched a consultation process intended to contribute to the “modernization” of EU procurement rules “with a view to simplifying and updating the European public procurement legislation so as to make the award of contracts more flexible and enable public contracts to be put to better use in support of other policies.”\(^{18}\) The range of these policies verges on the all-embracing: protection of the environment, higher resource and energy efficiency and

\(^{13}\) See Bovis, 2007: 17.
\(^{15}\) European Parliament and European Council (2004a and b).
\(^{16}\) European Commission, 2004: 2.
\(^{17}\) European Commission, 2011b: 4.
\(^{18}\) European Commission, 2011b: 3.
combating climate change, promoting innovation and social inclusion, and ensuring the best possible conditions for the provision of high quality public services. Corruption, together with “favoritism” is also listed as a consideration in ensuring sound procurement procedures.

Although now present, corruption still struggles to find its proper place among the other aspects and objectives of EU public procurement policy. It was hardly mentioned when the impact of the then procurement legislation was being evaluated (European Commission, 2004) in the run-up to the 2004 Directives. Two years down the road, in 2006, although the question whether the Directives had been effective in reducing problems such as corruption was posed, no attempt was made at answering it.

Still, corruption was explicitly referred to for the first time in the 2004 legislation through the provision that a bidder who has been convicted of corruption shall be excluded from participation in a public contract. Its appearance in public procurement legislation could hardly be surprising given the widely shared opinions about graft in government purchasing. Public contracting has, for example, the highest perceived level of bribery risk compared to other government activities such as tax collection, judiciary and utilities. Thus, the Article 45 provision must have been a relatively uncontroversial one in the political negotiations of the Directives which otherwise took almost four years.

Easy policies are, however, rarely effective. Debarring companies convicted of corruption would in all probability have a limited preventive or deterrence value since the likelihood of conviction, especially of large corporations, is not particularly high. As will be discussed in section 2.4.1 below, Norwegian courts, for example, appeared unwilling to sentence major private enterprises on corruption charges. Seven years into the 2004 Directives it is still a matter of hesitation whether “EU action in this field [anti-corruption provisions in procurement legislation] is needed or should be left to Member States.”

1.1.3. Policy Trade Offs

The range of costs and harms associated with corruption in general – and in particular in public procurement – is fairly wide:

“Corruption in procurement affects the efficiency of public spending and donors’ resources, creates waste and, ultimately, affects the quality of health and education services and the opportunities they present to improve quality of life. Corruption also harms companies that produce goods and services in this area as it increases operation costs, reduces competitiveness and, in the medium term, is not good business.”

19 Europe Economics, 2006: 59
21 OECD, 2009: 111.
Such a broad indictment presents a challenge not only to the resourcefulness of policy makers but also to analysts seeking to elucidate the drivers and circumstances that motivate economic agents to engage in graft. Would all or any of these externalities be reduced or eliminated should bribery be eradicated? As noted above, the perspectives on such questions from economics and law enforcement would differ.

Easy as anti-corruption is as a policy slogan, it could become discouragingly tricky when measures against it need to be squared with other key considerations. While circumscribing the negative effects of bribery, national and international public procurement procedures are also expected to reconcile a number of targets whose compatibility is not, to say the least, automatic within given resources – promote competition while maintaining confidentiality and often secrecy; be cost-efficient but as open and as transparent as possible; apply no preferences or discretion while pursuing a wide range of accompanying policies which require flexibility. Crucially for the purpose of the analysis here, furthering competition while at the same time providing against bribery may need a little extra policy ingenuity. The thesis that a “sound government procurement framework is a precondition for a fair and free competition-oriented market and helps to fight corruption” is in fact an assumption which Part II of this paper will examine. That the lack of competition threatens not only efficiency but also compromises integrity seems fairly obvious but has rarely been scrutinized. In EU’s anti-corruption thinking, “fraud, corruption and collusion” had been considered jointly.

That the impact of actual policies is not as straightforward as political intentions and may require choices to be made is increasingly acknowledged with respect to anti-corruption. In its Green Paper on the modernization of EU public procurement policy the European Commission admits that “there may be conflicts between the various goals.” The concern most frequently pointed out is that integrity measures could entail “disproportionate administrative burdens” and thus the added value of “the fight against unsound business practices must be carefully weighed against a possible negative impact on the overall objective of simplification of the procedures.” Conversely, “in responding to concerns about administrative complexity and cost, care must be taken, however, to preserve the benefits of a transparent and contestable procurement.” A similar trade-off may be applicable to the role of discretion. As commonly believed, “too much scope for subjective appreciation or arbitrary decisions could weaken sound procurement disciplines and complicate the task for contracting authorities.”

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24 Whether competition in public procurement – including across borders – itself should be described as a policy objective, rather than as a means to a more general public end, is a matter of another discussion. Suffice it to say here that substituting means for ends is not uncommon in policy areas short on vision.


27 European Commission, 2011i: 5.


added, and public procurement could cease to be an instrument for the ambitious range of policies it is increasingly associated with.

1.1.4. Towards an Evidence-Based Policy

Is anti-corruption policy then bound to remain a hit and miss affair desperately trying to keep up with a dynamic and elusive phenomenon? Or could it develop a pre-emptive capacity targeting corruption where it is expected to appear (be *ex-ante* rather than *ex-post*, to use the European Commission vernacular)? Much more than any other policy, anti-corruption is a hostage to practical politics. The fate of anti-corruption policy would therefore depend on its gradual emancipation from the mire of intergovernmental politics and its capacity of becoming – like most other EU policies – evidence-based.

Corruption being a “highly sensitive issue for member states” – the only one among the considerations now associated with public procurement defined in this way – appears to severely limit policy options. There are a number of reasons why anti-corruption should make governments more jittery than, say, a carbon tax. A key among these is mistrust of what passes as evidence – both the level of corruption and the impact of the anti-corruption policies are still being evaluated either through statutory reviews or surveys of perceptions. While other policy areas are being scrutinized through a range of measurement indicators, corruption is still the domain of unreliable assessments.

Although it is unlikely that anti-corruption would graduate to a common policy in the EU any time soon, any meaningful inclusion of anti-corruption as a procurement law consideration needs to be informed by a sufficiently elaborate understanding of the origins and dynamics of corruption in the various political, social and economic environments of the member states. As pointed out by the Center for the Study of Democracy (CSD) in its contribution to the anti-corruption consultation of the European Commission the EU should develop its own facility for measuring corruption which would allow it, among other things, to avoid catching up with corruption developments and to carry out risk assessments, including in government contracting. The methodology for evaluating corruption prevalence and corruption risk in public procurement, applied in a CSD study of 2006, as well as CSD’s Corruption Monitoring System, a measurement methodology implemented in Bulgaria for over 14 years now, would be appropriate starting points for such a facility.

In the Stockholm Program – a document that details the strategy in what is known as the area of freedom, security and justice in the EU – the

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31 European Commission, 2011b: 47.
32 See also footnote 12.
33 Center for the Study of Democracy (2011b).
European Council tasked the Commission to develop indicators to measure efforts in the fight against corruption, in particular in the areas of the acquis such as public procurement. 36 If, as argued in this paper, differences in the prevalence of corruption among countries are likely to be smaller in public procurement than in society at large, a method of diagnosing corruption in bidding competitions is all the more needed.

1.2. Public Procurement and the Rise of Governance-by-Project

Means, of course, shape ends; outcomes are dependent on the tools employed. And so in public policy – the nature of the delivery mechanism could make or break any policy, however elaborately designed. Thus, a brief discussion of one of the major developments in the governance and management culture in modern industrialized societies is required at the outset of an analysis of the changing role of public procurement and the consequent expansion of its regulation, including internationally. A shift from hierarchies, fixed structures, work in discrete, long term units and routine tasks to working environments characterized by flexibility, non-linearity, networking, and project-based organization has been taking place in both the corporate sector and public administrations.

What has been dubbed “the new spirit of capitalism,” after the seminal analysis by French sociologists Boltanski and Chiapello (2005) and in reference to Max Weber’s earlier notion, suggests that during the last decades the basic ‘working cell’ in the developed economies has undergone a major change towards project organization. Previously, the typical productive organization was of the continuous input-output type. It was typically composed of a regular workforce under a stable hierarchy. Project organization with its continuous input (over a limited time span) and point output design was mainly used in construction. Today, it is applied almost everywhere. Moreover, projects are designed so that they result in a salable output. When applied extensively this way it allows employee contracts to be limited to the life time of the project. Moreover, a project consists of a set of linked tasks performed by a number of participants that may vary significantly over time. Hence, a large fraction of the workers involved may have to move to another project before its completion. When the project is completed, the remaining participants may have to terminate their contracts with the temporary payment hierarchy for eventually to be engaged in a new one. While the old ideal was to organize the systems of production or service deliveries under the same hierarchic umbrella the present ideal is the opposite: to outsource as many activities in temporary project organizations with a circum-

36 European Council, 2010: point 4.4.5.
scribed financial life. Earlier, according to a number of management researchers, common membership made it easier to create flexible work units. Today, the ideal of a shared hierarchy for project workers is gone and substituted with network ideals.

If a new project is not managed by the same financial hierarchy as the preceding one, the workgroup performing most of the task-solving remains temporary. In order to ensure a regular stream of tasks – and income – each worker or work group has to become a trader. Then each trader needs their own network to learn about new and relevant project opportunities and to influence the likelihood of being assigned to a task.

The increased role of project organization, where a number of individuals cooperate on a shared task but are paid by different budget units, has spread to the public sector. A sequence of project organized activities is now seen as capable of substituting for some core activities in a public hierarchy and hence allows its core part to shrink. Crucially, this shift allows a wider role for its procurement of private sector services. It implies that the accomplishment of tasks formerly done inside a given public organization would now require the involvement of several organizations, both private and public, whose coordination involves joint private-public task sharing, but also a disbursement of public sector funds to private enterprises.

Nowadays public procurement of services and their regulation has an additional impact on public sector operations as well as the mode of operation of the private sector. While it is possible that the chopping up of task sequences so they become implementable by project-like groups with both private and public sector members is more economically effective and makes better use of specialized knowledge in certain situations, it is mainly an ideologically driven movement intimately related to deliberately engineered and often aimless institutional changes in the public bureaucracies (Andvig, 2001). From an efficiency point of view its drawbacks are that it is likely to increase transaction costs as well as create divided loyalties thus potentially stimulating corruption. Another effect with uncertain efficiency is that an increasing share of public officials becomes closely connected to private sector networks and may move to private organizations or create their own. The latter is surprisingly easy in Norway where it is legal for public officials to own private firms or be employed in such, as long as they spend at least 37.5 hours a week on their tasks as public officials. Although legally strongly restricted in Bulgaria, a number of ways of bypassing the law have been analyzed in the reports of the Center for the Study of Democracy. The project organization of public procurement carries a number of governance risks which will be discussed in Part II.

37 Not all outsourcing of public sector services can be performed through project organization. The outsourcing of service activities, such as care for the elderly, has to be on a continuous input-output basis. But time limits still have to be specified in advance in order to allow it to be procured on a regular tendering basis.
38 In Moen (2010) it is empirically demonstrated in the case of the administration of NAV, the Norwegian Labor and Welfare Organization, that it is those parts of the administration that undergo the largest changes that have the most consultancy contracts.
A development that has received considerable attention is the growing use of consultants in public administration. Such developments started in Norway and elsewhere in the 1980s and their use in public administration implies ipso facto increased public procurement – in order to comply with regulations a large number of tenders have to be arranged. Despite the obvious importance of these developments for the public administration, there is no proper aggregated data on consultancy use even at the central government level. Yet, existing case studies such as Moen and Moland (2008) have looked at the use of consultants in three different sectors of the public administration in Norway and found that the expenditures on consultancy varied from 11% to 34% of the total wage expenses. The consequences of shrinking core organizations combined with a stock of temporary publicly financed projects, flexible in numbers of upward and downward adjustments, are borne not only by the public administration but by society as a whole.

**Box 1. The impact of project-based management in public healthcare**

The story of a local hospital in the Oslo region aptly also illustrates the wide-reaching impact of public procurement rules in a project-based society. The hospital is integrated into one of the regionally based state hospital conglomerates, introduced in 2000, that constitute the present core of the Norwegian health care system. Each hospital receives a fixed state grant but a significant share of their income is based on “results.” As in any such system, the results are liable to manipulations since the economic incentive to do so is strong. As part of a complicated incentive package the hospitals are obliged not to delay treatment after a certain fixed time period running from the moment when the patient is diagnosed. The time period varies according to the kind of condition diagnosed.

If doctors are unable to give treatment within the prescribe deadline, the hospital has to send the patient to another hospital and pay for his/her treatment. Hospitals may then easily be suspected to manipulate the date for delivering the diagnosis to avoid this expense.

In the case of this particular hospital, there is reason to believe that the manipulation of the data was more extensive and deliberate than elsewhere. The head of the surgical department was responsible for these and other manipulations of the complicated incentive structure. When the story was publicized, he was quickly fired which consequently reduced media interest in the follow-up. It was revealed that the head of the surgical department, who had no surgical competence had in fact been hired from a consulting firm probably on the basis of extensive experience on manipulating the incentive schemes, and therefore knowing how to bring about economic results that could satisfy public procurement rules.

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40 Jernbaneverket [Norway’s railway infrastructure administration] increased its consultancy expenditures with 62%, while its overall investment expenditures increased with 47% from 2006 to 2007 (432 million NKR) after a period where the state railway had been partitioned into several organizations each consisting of project groups that could rent in labor when needed. The state road administration spent 1.1 billion on consultancy in 2007, a 36% increase since 2003 (Moen and Moland, 2008). Recently, NAV spent 20% of its expenditures (about 3.8 billion NKR) the last three years on consultancy services (Aftenposten, March 27, 2010).

41 Note that the flexibility referred to here is in terms of public employment. As was evident from the aftermath of the breakdown of the dikes protecting New Orleans, the necessary haggling to bring in the private suppliers to the catastrophic scene made the public response slower and less flexible than when more capacity was kept in-house.

42 A critical study of other qualitative consequences to the research sector stemming from applied social science research based on project financing is discussed in Andvig (2008).

the medical authorities. When the scandal broke, an additional advantage of the consultancy status was discovered: he could be immediately fired. The reason given was that the hospital had broken the rules for public procurement and had not organized any competitive bidding for the services.\textsuperscript{44} Thereby the responsibility chains were broken, and the individual who had the most intimate knowledge about the manipulations had the duty to convey his knowledge.

\textbf{Box 1. The Impact of Project-Based Management in Public Healthcare (Continuation)}

\begin{marginfigure}
\centering
\includegraphics[width=\textwidth]{figure2.png}
\caption{Sequencing in the Public Procurement Process}
\end{marginfigure}

1.3. Balancing Policies: Competition and Anti-Corruption in a Governance Trade Off

Models of procurement bidding

A lot can be implied simply by looking at the time line of the typical public procurement process. Unlike a regular purchase by a private buyer, public procurement involves a number of stages intervening between the decision to buy and the actual purchase; in fact, it is typically quite a time consuming process.

In the simplest case, a public actor may purchase goods in the same manner as any regular citizen or private enterprise are allowed to do, but if the purchase price is above certain thresholds,\textsuperscript{45} public agencies are obliged to arrange their purchasing through time consuming auctions that roughly follow the sequence outlined above. The size and nature of the purchase determine the exact rules that apply to the type of auction that is chosen. According to EU laws, the public procurement auctions are divided into

\textsuperscript{44} This hospital moved from a deficit in 2007 to a surplus in 2008 making it the only profitable hospital in the country (Office of the Auditor General of Norway 2009: 62 – 66).

\textsuperscript{45} At present, the threshold in Bulgaria is the equivalent of €7,500; for Norwegian municipalities the limit is 500,000 NKR, for the state 1,000,000 for regular purchases. The EU thresholds are somewhat higher, €125,000 for public supply and service contracts, €193,000 for contracts awarded by some semi-public authorities and €4,850,000 for so-called works contracts. Hence, thresholds vary both with the characteristics of the item purchased, and with the characteristics of the public authority that procure them.
four main types: the open procedure, the restricted procedure, the competitive dialogue and competitive negotiated procedure. Each of these has its own set of rules which are designed to fit the complexity of the item or service procured. In the first two, auctions are arranged at the outset – the first between everyone willing to make a bid; in the second, the auction is restricted to a number of predetermined qualified competitors. In the competitive dialogue, information is shared with at least a subset of the predetermined set of bidders, before the auction takes place, while in the final form no auction may be arranged at all. Negotiations are applied in the final stage of the procurement process, too.\textsuperscript{46}

The bidding rules deal with: 1) how the procurement auction is going to be published; 2) the qualification criteria for prospective bidders; 3) the criteria for winning the contract; 4) what kind of information is allowed to be communicated between bidders and between them and the procurer; 5) the stage at which eventual communication is allowed; 6) how the evaluation process is to be performed, (for example, whether the technical characteristics and the price information in the bids would be evaluated separately); 7) which complaints would be allowed and when they may have an effect on the final decision; 8) what kind of discrepancies would be allowed between the original bid and final outcome; 9) stipulations of when and what kind of sanctions are applied to cases of breaking the rules.

In the ideal type of the procurement process, the public authorities are able to specify their exact needs independent of the suppliers’ capabilities. The suppliers formulate their bids independent of each other and without any contact with the procurer. The lowest bid wins and the winner executes the contract without further negotiations. The number of potential suppliers should be as large as possible and the bid publicized as widely as possible. In an EU context, it is particularly important that potential bidders from various member countries are informed and allowed to participate without any preference to local suppliers.

An important motivation for public organizations to arrange bid auctions is of course to supply the citizens with as many and as inexpensive public services as possible. The main reason why public bidding processes are believed to be a useful instrument is the suspicion – partly based on factual evidence\textsuperscript{47} – that, for a number of reasons, public procurers when not restrained by obligatory bidding auctions are less price sensitive than private procurers. As a consequence, the public goods and services based on these procured items would otherwise become unnecessarily expensive. Ideally however, an auction should be only arranged if the costs for arranging it are lower than the expenditures saved through a lower price. Most national procurement legislation, as well as that of the EU, does not specified rules for how procurement costs should be

\textsuperscript{46} The following analysis will only occasionally go into the details of the different procedure forms – since this could lead the discussion into a maze of legal and technical details – but will instead stick to the main principles and ideals in the public procurement auctions.

\textsuperscript{47} While this suspicion is not well evidenced, it is probably well grounded. Having received access to the books of a large importing firm in Asia, Cole et al (2009) report that governmental organizations pay on average 21% more than private firms for the same goods.
introduced for the choice of legal bidding procedure, but they may of course have so in practice, and for the actual violation of rules.

Yet, in reality the items or services procured are rarely so simple that a single price can determine the value of the outcome. Moreover, at each stage of the process, the agents involved may have reasons not to comply with the rules. Hence, a large set of rules about how to complain and how to punish rule breakers has evolved.

**Corruption risks**

Underlying the development of the public procurement rules is also a fear from corruption in public bureaucracies and the potential threat against democracy by the misuse of public procurement for political control. Procurement, if unfettered by rules, gives any incumbent government strong powers to dispose favors to ensure its political survival. Thus, the likely effects of the procurement rules not only on economic efficiency but also on political behavior have been driving the development of procurement legislation, including at the EU level. For example, when a new law made competitive bidding compulsory for local transport in France (the 'Sapin' Act) in 1993, the major arguments for it were to prevent collusion between the local party in power and the transport operators with the subsequent corruption in addition to arguments about increasing competition and lowering costs (Yvrand-Billon, 2006). Whatever the motive, it is apparent that public procurement processes have become more heavily regulated and cumbersome than those in the private sector both in Europe and world-wide.

As will be evident from the discussion below, corruption risks in public procurement are indeed serious even in countries where the public administration is mostly non-corrupt, and these risks are present at each stage of the process. Little empirical research has been done to document whether stricter and simpler rules would actually reduce corruption. It appears likely that corruption may be reduced through this extensive elaboration of rules, although they have negative side-effects too.

While corruption risks are present at each stage of the procurement process, the risks are not present to the same degree. The process also involves a different set of actors at each stage. It is in the first stage that top level political corruption is a serious governance risk, mainly when it comes to large scale procurement projects. Informal agreements be-

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48 Arrowsmith (2005: 129) cites from an argument by the European Court of Justice: "The main purpose of regulating the award of public contracts in general is to ensure that public funds are spent honestly and efficiently ... without any kind of favouritism or quid pro quo whether financial or political."

49 A study from Asia (Tran, 2008) suggests that when it is possible to apply a best price procurement auction, such auction is less amenable to corruption than the less stringent best value auction (that is an auction where the success indicator is composed of a number of technical and price components that makes it more vulnerable to manipulation). The best value auction rules generated more corruption, however, than when the public authorities were not obliged to arrange any bidding competition at all. On the other hand, absence of bidding rules led to more corruption than best price auctions.

50 Based partly on personal observations from a number of developing countries, Moody-Stuart (1997) outlines expenditure classes for the cases when top level politicians, high level bureaucrats, and regular bureaucratic decision makers demand cuts. Interestingly, they may get involved and provide consultancy for much lower payment.
tween the relevant politicians and a major supplier are almost impossible to prevent and difficult to uncover. Formulating a bid that leads to a pre-determined supplier as the most likely winner of a competition, however, would require extensive planning involving a number of public agencies. It would also imply that the actual public bureaucracies are either receptive to bribes themselves and/or may be led by informal political signals. Alternatively, the whole procurement process – including its planning – may be delegated to a private bureaucracy. This solution would be in line with the prevalent management ideology in a project-governed society. In this way, a large part of the planning process could be moved out of public scrutiny and it becomes easier to organize eventual high level corrupt deals, either through taking bribes from the private procurement agency or through giving it political instructions.\(^5^1\) Moreover, such a delegation may become a technical necessity when the public organizations become stripped of their relevant expertise, according to the same form of management ideology.

Political level corruption or brokerage is not the only form of corruption possible at this stage. Subtle, lower level technological information leading to particular suppliers may be fed into the planning process, although it is probably more important at later stages. Process 2 from the above chart is the stage when cartels are most likely to be organized. Rule-breaking information about bids is sold and bought, which continues into Process 3 that is otherwise the stage for bribing the formal decision makers (again, the actual evaluation of bids may be delegated to a private bureaucracy). During the actual construction of the procured object or delivery of a service, a large number of new bribing possibilities may arise, particularly in connection to the so-called change orders. These arise mainly in complex projects where some unplanned work has to be performed and the corresponding expenses incurred. In such cases there is an issue whether such expenses should be incurred by the supplier or the procurer. Both may offer bribes to the involved engineers so that the latter present information that will make the other organization responsible for the payment.\(^5^2\) In more complex cases a number of private and public bureaucracies may be involved.

**Monopolies and competition**

While corruption is a real issue when it comes to public procurement and the insistence on formalized public bidding processes may have some value as an anti-corruption device, the latter has not have been the main motivation although it has received more attention recently (S. Williams, 2006). In many policy statements, however, it has been the creation of a competitive market that has been put forward as the major objective. Even if enhanced competition could be recognized as a goal – rather than

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51 An example of this form of delegation is presented in section 2.4.2 below. Wedel (2009) describes the international developments of a number of cross-agency, cross-country elite networks that have the capabilities of manipulating public auctions this way. In the US, she notes (chapter 4) that there has been a return to keeping mega-contracts outside the bidding rules altogether.

52 It was the attempt of an information broker, who tried to bribe an engineer in the operating oil company on behalf of a supplier to make the engineer issue a change order to the advantage of his client, that led to the discovery by the Serious Fraud Office of larger scale corruption cases in the North Sea oil sector. See section 2.3 and the references therein.
a tool – of public spending, it is not immediately obvious what kind of regulation promotes it. While it could be argued that allowing suppliers/bidders from different member states to compete for any public project may create a cross country market supply side, each public procurement decision is often unique and the public agency is forced into a monopsonistic position. If really committed to get the object cheaply, the public agency could get it even below market price. If internationalization takes place at the demand side – a larger number of governments invite the same group of suppliers – this monopsonistic position is lost. Increasing the number of potential suppliers does not necessarily bring the price down; instead, it could simply increase the size of the bribe that has to be offered, or make the bidders more careful with their bids each fearing that they may be stuck with a bid that is too low. It is also not obvious that bringing more governments into the same public procurement market will increase prices. On the other hand, bringing in more governments into the same market allows benchmarking of public procurement costs.

In general, the short-term effects of increased internationalization of bidding for public procurement are likely to be in decreased prices, while the longer-term effects may be more uncertain. The short-term effects would be mainly due to the possibility of applying benchmarking to the public bureaucracies involved and increasing returns for the private suppliers, whereas the doubts about the long-term effects are related to the prospects of international cartelization. As we will evident later in this paper, the effects on corruption risks are even more uncertain. The main point, however, is not to render all the complexities of the case in order to determine the expected outcome of increased internationalization of public procurement processes; this could hopefully be settled through empirical research, at least for the price effects. The goal is rather to underline the fact that simple market analysis will not do when dealing with the interaction between complex bureaucratic entities restrained by a set of complex bidding rules.

**Governance trade offs**

This complexity is justified partly by the variety of goals pursued by the detailed regulation of public procurement but these goals are not always and not necessarily compatible. Some trade-offs between different governance objectives are internal to the specification of the bidding rules. Of key significance to the discussion here is that some forms of increased transparency during the bidding progress may reduce corruption risks but may increase the risks of cartels. This risk is acknowledged by the European Commission in its Green Paper which notes that the transparency of the procurement process is actually conducive to cartel-building.55

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53 In economics, a monopsony is a market form in which only one buyer faces many sellers.
54 This argument is based on the reasonable assumption that public procurement auctions are not private value auctions (Amaral et al, 2009). This implies that the risk of getting into a “winner’s curse” position (further discussed in 2.3. below) increases with the number of participants. The first argument is somewhat simplistic, but it gives a general reason why there should not be a close negative correlation between the degree of bid competition and the corruption risks, as assumed in most policy debates about the use of auctions in public procurement. This argument will be further explored in section 2.7. below.
This happens in two ways. **First,** making the bids more public makes it more difficult for the procurer and one of the suppliers to make a secret bribe deal but, on the other hand, it becomes easier for the suppliers to inspect the competitors’ bids and thereby monitor potential cartel agreements. **Second,** by demanding **more specified bids,** the procurer may arrange a first price auction where it is easier to control corruption, or it becomes easier to avoid it during the implementation process. On the other hand, this demand for specificity makes it costlier to win a contest (at a fixed cost) which may keep the smaller suppliers out of the race and thus prevent any cartel agreement from being challenged.\(^\text{56}\) The costs of bid specification may become considerable. In social science research bidding, for example, despite the fact that a large fraction of the research grants are distributed through tenders where the principle is the best quality to a given price (not lowest price competition), the tenders are, for all intents and purposes, highly specified, with the corresponding high bid costs. In the case of Norway, according to rough estimates (Førsund 2006), about 100 hours have to be spent on each bid. With a success rate of 10% and an hourly rate calculation rate of NKR 1,000 per hour, it means that each grant of about NKR 3 million costs the society 1 million in bid costs in addition to the regular administration costs of the Norwegian Research Council.

Other governance trade-offs may also arise from the different specifications of the rules for the bidding contest. With regards to the implementation consequences, more highly specified bids may increase costs during construction, but specification may also prevent learning by doing through the informal cooperation between procurer and supplier and thus stifle innovation. Although these effects are beyond the scope of the current paper, they are arguably more important than the consequences of bribery or cartel collusion. Although innovation is among the professed objectives of the rethinking of the European procurement regulations,\(^\text{57}\) the risk that combining rigidity and complexity in the regulatory regime of bidding could contribute to an ossified economic structure in the EU area should be carefully examined and not easily discarded. It is thought provoking, for example, that while the major purpose for introducing a cumbersome regime of bid competition is to simulate developments in the private sector private enterprises themselves appear to avoid it.\(^\text{58}\)

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\(^{56}\) In addition, it may increase the risks of industrial espionage. This effect will be examined further in section 2.3 below.

\(^{57}\) European Commission, 2010: 12.

\(^{58}\) A study of Bajari et al (2008) on the procurement practices in the construction industry in Northern California shows that, in 1995, open competitive bidding was applied to only 18% of the contracts for private sector’s non-residential building. Meanwhile, 44% of the contracts were determined by direct negotiations. In comparison, 97% of the public sector building construction contracts were awarded through an open competitive bidding process. While this indicates that the priority given to competitive bidding is not unique to the EU area, it also suggests that the public sector might be losing efficiency. This may partly explain why such a large fraction of the documented corruption cases in Norway appears to be in the building sector. When former private sector employees are employed in the public sector, they may simply carry over their private sector practices. Or the public employees may simply copy the private sector’s practices.
2.1. The Volume of Public Procurement in Norway

Given the shift towards a society where an increasing number of institutions function on a project basis, as described in section 1.2 above, a reasonable expectation would be for a significant increase of public procurement in the share of GDP in Norway. Yet, this has not been the case. During the last decade, public procurement as a share of GDP did not rise above its 1995 level when it constituted about 16% of GDP (Ministry of Trade and Industry, 1997: 19). According to Statistics Norway, during the period 2001 – 2008 public purchases as a share of GDP varied between 13.6% (2001) and 15.2% (2003); in the most recent year registered (2009), the share was 16.2%. Thus, there is no clear trend in the share of public purchases from the GDP, yet the nominal amount has increased from NKR 209 billion in 2001 to 386 billion in 2009.

Three main types of purchasing institutions are distinguished: the central government (including defense), the local government, and ‘general government enterprises’. The latter are mainly government enterprises that are not set up as limited liability companies and are not very profit-oriented. In 2009, central government purchases constituted NKR 171 billion (of which defense purchases were 25 billion), local government purchases constituted 130 billion, while general government enterprises paid out 84 billion. While the ratio of purchases between the central and the local government could change significantly (from about 1.4 in 2008 to 1.0 in 2001), it is the general enterprises’ procurement that has been truly on the increase during the period. In 2008, general enterprises purchased goods and services for NKR 96 billion, in 2001 this number was 35 billion. The rise is largely attributable to the petroleum industry component of the general enterprises (72 billion in 2008 and 24 billion in 2001).

Norway is obliged to follow the EU regulations through the EEA (European Economic Area) agreement and the WTO Agreement on Government Procurement (GPA). The legislation concerning public tenders above and below the EEA threshold is mainly the “Lov om offentlige anskaffelser av

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60 For the rough estimations in this paper, €1 = 2 Bulgarian levs = 8 NKR.
16. juli 1999 nr. 69” (the Public Procurement Law) and the regulations regarding public procurement of April 2006 by the Ministry of Government Administration and Reform, the institution responsible for procurement legislation in Norway.

The number of Norwegian tenders registered in EU’s tender database (TED) was 900 in 1994 and 2,400 in 1995 (Ministry of Trade and Industry (1997: 19). In 2008, TED received 4,871 notifications from Norwegian public entities to a total value of NKR 53 billion (14% of the Norwegian public procurement aggregate, 15% in 2007). Among TED tenders, 92% of the bids were selected on the “most advantageous offers” basis and 8% were “lowest costs” bids. About 30% of all TED tenders were awarded through “framework agreements,” while “negotiated procedures” were used in 17% of the tenders. The corresponding Norwegian database, DOFFIN, received 8,157 tender notices to a value of NKR 1 billion (6% of the Norwegian public procurement aggregate, 7% in 2007). Examining the national tenders in 2008, 89% of the contracts were selected on the basis of the most advantageous offer, while around 11% were selected on the basis of lowest cost. Some 13% of all tenders were framework agreements and in 230 tenders negotiated procedures were used. Altogether, about 20% of the public purchases were covered in these databases in 2008. Given the strong pressure for competitive and transparent bidding, the share of public procurement registered in the two databases is surprisingly low, as is the low share of lowest cost bids. Yet, the latter type of bidding is the professed ideal of public procurement regulations.

There is no central public procurement agency in Norway, except for the procurement activities of hospitals. In 2008, 1,366 public entities sent notifications to the databases indicating the number of tenders organized by a public organization. As regards bidders, the number of participants is impressive: 830,000 suppliers were involved in purchases by central government entities alone. Yet, the portion involved in organized tenders is not specified. For the whole range of public purchase contracts, the Norwegian Complaints Board for Public Procurement (KOFA) received only 143 complaints in 2008.

While these numbers are indicative of trends, it is not possible to come up with any precise estimations of the economic value of different parts of public sector procurement. Nor is it possible to identify from the DIFI’s reports the economic value of the public sector’s purchases from the various business sectors. The reports list, however, the number of notifications for each public entity. It is clear from this list that the largest municipalities together with the regional road authorities, hospitals, and universities are the ones with the largest number of notifications. Yet, the reports provide no explanation of the kinds of

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61 The information in this section is based on the annual reports for 2007 and 2008 of the Agency for Public Management and eGovernment (DIFI’s). DIFI is responsible for monitoring and managing public procurement rules on behalf of the Ministry of Government Administration and Reform.

62 These forms will be discussed below. Note that they are not all mutually exclusive. For example, a framework agreement may very well be a “most advantageous offer.”
mechanisms that determine why some public purchases are publicized while others are not, nor do they explain who is winning the bids (i.e. national Norwegian, local, or foreign/multinational companies). In particular, just from the share of public procurement in the GDP it is impossible to establish whether the management ideal of lean public organizations combined with temporary use of private sector services is achieved or not. For this, a more discriminating registration of relevant events is necessary, such as when some services are outsourced to private businesses, their purchases may or may not be registered as public procurement.

Some of the difficulties involved in matching relevant procurement decision makers with the corresponding registered public purchases may be illustrated by procurement in the oil industry. Extensive public procurement has been a precondition for the build-up of this industry in Norway. Although part of the capital ownership of the extraction installations is private, other parts are publicly owned in one institutional form or another. Moreover, this is a sector which, at least until recently, had been developing under state direction, and the state still has extensive ownership interests.

2.2. Procurement in the Norwegian Oil Industry: An Overview

During the last three to four decades, a large petroleum industry has developed in Norway. The industry is in fact so large, that it significantly impacts public finances and the political and economic processes in the country, making the regulation of this industry into a key issue of national public governance. The industry is complemented by a large offshore supply sector systematically built through the use of public procurement practices.

Somewhat paradoxically, by stimulating their growth, Norwegian political institutions have almost lost public control of petroleum extraction. The industry pressure groups have so far been able to prevent any serious reduction in exploration and extraction rates, despite this being potentially advantageous for a number of macro policy reasons. The combined political and economic power of the petroleum and offshore supply industries makes it almost impossible for Norway to seriously cut its CO2 emission rates through internal policies. To achieve this goal, which is strongly supported by the Norwegian political elite, politicians have been forced to contribute in rather roundabout ways. One of the main methods used is by financing (through the so called Government Pension Fund) Global, a facility into which the surplus wealth produced by Norwegian petroleum income is deposited – of incentives for other countries to preserve their rain forests.63

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63 This fund plays a large role in Norwegian economic policy. It is based on the surplus from the petroleum industry and has legitimized the high extraction rate of Norwegian petroleum resources by shielding the economy from the strong demand pressures that would otherwise have arisen. Added to the investment pressure necessitated by the development of the oil industry has been the development of kind of less serious “Norwegian disease” (compared to its Dutch version which als gained currency in economics): the neglect of the development of land-based infrastructure.
From the beginning of the development of the industry, there has been a clear political (and legal) assumption that, like hydropower resources, oil and gas resources belong to the people (or in this case the state). How to extract these resources and share the revenue were issues of public policy. Initially, the public stake was ensured by the establishment of the state-owned company Statoil, which could build up state control after it had acquired the necessary technical and economic expertise. After its establishment in 1972 as a wholly state-owned enterprise, Statoil gained so much economic and political power that efforts were made to rein it in. From 1985 onwards, this was sought by adding an investment organization to Statoil – the State’s Direct Financial Interest (SDFI) – where the state would use its original ownership rights to the sea bed to acquire a definite share in all the larger oil and gas development project contracts allocated through the Ministry of Energy and Petroleum. This meant that fewer shareholder rights to future oil and gas extractions were sold/handled over to Statoil by the Ministry.

After 2001, some of the management tasks from the SDFI’s portfolio were moved away from Statoil to a separate state enterprise, Petoro, supervised by the Ministry of Petroleum and Energy. Since, Petoro has had mainly monitoring functions, although at present it shows an interest in shouldering a more active role. To ensure that Petoro would not interfere too strongly with Statoil’s fields of interest, however, the Parliament determined an upper limit to the number of employees for Petoro (60 employees). In the same operation, Statoil acquired some of SDFI’s former ownership rights that allowed Statoil larger financial scope and an international expansion that further increased its political and economic clout.

In 2007, Statoil was expanded through a merger with the gas and oil division of Hydro, and became StatoilHydro. It was a merger between the two most powerful enterprises in Norway. It is now a limited company (an ‘ASA’) with a number of private owners in addition to the state. Despite the fact that about 2/3 of its stock is owned by the Norwegian state, it is defined outside the set of institutions that comprise the basis for the official statistics on public procurement. At the same time, StatoilHydro makes de facto most of the actual decisions in public procurement in the oil industry, though its purchases are not counted as public procurement in the official statistics. Some of the public (SDFI) procurement is done by other private enterprises. The reason for the discrepancy between Statoil and public procurement in the petroleum industry is simple, but in order to understand the actual procurement process, it will be useful to take a brief look at the way the offshore oil industry is organized.

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64 Hydropower resources were often handed to local governments since the long distance transfer electricity systems were not sufficiently developed at the beginning of the 1900s when most of the power resources were developed. This happened at about the same time as Norway gained political independence from Sweden, so ownership rights to power resources became part of a Norwegian nationalist ideology.

65 Statoil recently merged with the petroleum division of Hydro and was called StatoilHydro. At present, it is again called Statoil, however. In the following, the name applicable at the time of events discussed will be used.

Partly due to the large economic risks and amount of capital involved, the costs of developing oil and gas fields (as well as the future income) are shared by a set of license owners. In the end, the allocation of the ownership rights was decided by the Norwegian state. One of the participants – often the largest owner in terms of production capacities – is chosen as operator responsible for the technical and organizational development of the field (or other large-scale constructions such as gas pipes) in consultation with the other owners. It is the operator that does the actual procurement, organizes the bidding procedures, makes eventual change orders during the construction, and covers possible cost overruns by the suppliers. The main procurement agencies here have been Norwegian state enterprises, so these are not *stricto sensu* public procurement examples. Yet, the development of the industry has been the largest public economic task of the Norwegian government in the last four decades. This practice corresponds to the logic of the so called *fourth generation* of secondary EU legislation which considers such enterprises to be sectoral contracting authorities.

Later the costs are distributed among owners according to their ownership shares. The operator is obliged to share a considerable amount of technical and economic information with the other license owners. StatoilHydro is the organization that has the largest number of operator contracts on the Norwegian Continental Shelf (NCS).

In addition, like other oil companies and the state through SDFI-Petoro, StatoilHydro also holds passive shares (or licenses) in the projects of other operators. At the turn of the year 2008/2009, SDFI held licenses in 122 fields of which 40 were actively producing. SDFI also holds ownership shares in a number of other installations such as oil and gas receiving terminals. SDFI-Petoro’s share of costs in the projects it owns constitutes most of what is counted in the official statistics as the contribution of “general government enterprises” to public procurement (i.e. the sum of their purchases of goods and services and their gross real investment). In 2008, their contribution to public procurement was NKR 73 billion – almost 20% of total public procurement in Norway, although this is mainly reflecting a passive position. StatoilHydro is the organization that currently manages most aspects of the actual public procurement activities where SDFI-Petoro shares the cost in accordance to its ownership rights.

The basic risk-sharing institutional device in the oil industry, where the operator – the main decision-maker with respect to procurement – shares its costs with a number of license or share owners, may reinforce the risks of serious cost overruns. Such overruns are caused by the mix of technological and organizational complexity that is characteristic of a large share of the industry’s procurement. Fixed price tenders, the standard procedure for keeping costs down in public procurement, are often impossible to accomplish in practice. They require some form of cost-plus arrangements that easily cause cost overruns. Sometimes most of the procurement decisions can even be transferred to the main supplier.

*From a strictly economic point of view, cost overrun is probably the most serious governance issue of the oil industry procurement.* It has
caused the ousting of two out of four CEOs in Statoil, and has led to the emergence of a new Norwegian expression: a “Mong.”67 A third CEO had to go because of another governance issue – corruption. Consultants employed by Statoil had bribed Iranian officials, as admitted by Statoil in 2003. While this is a form of corruption that can conceivably be in the interest of the company, corruption in procurement is clearly not. Hence, in cases of corruption by agents of an oil company aiming to get access to resources or influence the government’s tax policies towards the industry, it is much easier to suspect that it has either been directed by enterprise managers or being intentionally overlooked by it.68

67 A Mong is derived from Mongstad, where a Statoil project led to cost overrun of 1 Mong. The conventional final value was set to 1 Mong = NKR 6 billion. According to Evju (2008), the real final value was NKR 8.3 billion. While still surviving, the present CEO of StatoilHydro has also been plagued by a serious cost overrun in the Snøhvit project (See Box 3.). As of early 2008, the overrun was equal to 4 Mong according to Nationen (January 24, 2008).

68 The corruption and governance issues that involve Norwegian enterprises’ expansion abroad are in many ways potentially more serious than the ones discussed in this report which focuses on the relations between Norwegian public or quasi-public organizations and their private suppliers.

69 This story is a summary based on a set of articles in the newspaper Stavanger Aftenblad (October 8, 10, 13, 19 in 2009, January 15, 2010). The legal basis for the compensation was not the cost overrun as such, but that the companies (and the State through SDFI) would gain less from the installments where the cost overruns were the highest.

70 In the excess demand situations of the former socialist economies, or in a war economy with rationing, the situation may be the opposite. Here the procuring agency may incite bribing in order to let a supplier release its control of resources. While not strictly the same, financial markets in market economies may experience situations where the buyer of a financial asset may induce the supplier to lend through the promise of a bribe.
cess that allows procurement officials to receive bribes, or of selling bid information illegally. Yet, purchasing organizations will only rarely receive the bribe themselves.

That being said, because of the complex forms of cooperation and competition in the sector corruption in the petroleum industry is more difficult to contain, compared to regular procurement in a centrally governed company. Moreover, corruption in this sector is particularly significant in Norway due to its relative size, the volume and complexity of a typical procurement project, and the prominent role of public ownership rights and quasi-public management in the sector.

While some of the governance issues here are specific to the petroleum industry, most apply to public procurement in general, especially to public procurement for large construction projects. In Norway, the petroleum industry has pioneered the project-based forms of organization on a large scale. For any given technological development, the procuring organization (i.e. the oil company chosen as an operator) has become quite lean compared to the set of tasks it needs to solve and has thus to rely on additionally hired enterprises in order to implement projects.

In the Norwegian oil industry, the bidding was international from its outset, as it is now for almost all large-scale public procurement projects due to the international legal frameworks that Norway has joined. Because of the large scale of procurement activities and the quasi-public nature of the main organizations, it is within the oil companies and the state regulating institutions that we find the most systematic and extensive experience with (quasi) public procurement and international tendering in Norway. The size and strong external effects (on environment as well as on public finances) of each single construction – and therefore also procurement – project in the oil industry reinforced the state’s ownership claims and made the outcome at least quasi-public (oil and gas are resources that should be exploited for the common Norwegian good, according to the Norwegian Petroleum Law).

The dominant organization that does the procurement on the NCS at present, Statoil, has remained quasi-public, although strong efforts were made to privatize it. Statoil is in fact the Norwegian institution that organizes

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71 It could be roughly estimated (based on the cited table on public purchases and from table 291 and table 388 in Statistisk Årbok 2009) that in 2008, the petroleum sector spent about a quarter of Norway’s aggregate gross investment, as well as a quarter of the public sector’s gross investment purchases. The state receives about 1/3 of its annual revenue from StatOilHydro managed activities (a rough estimate for the year 2005 based on Tables 2.2 & 2.3 in Statistics Norway, 2007).

72 Norway was able to build in a surprisingly short time a large and geographically outspread supply industry reflected in the high Norwegian share in the supplies to Statoil. This was an outcome from a mix of historical circumstances: 1) The state worked out national procurement preferences that would be impossible to implement today with the present international legal framework – Statoil was quasi-public and an important instrument; 2) the geographical advantage for a number of supply activities was considerable; 3) the pre-existence of a fairly large ship-building industry and a heavy industry that could be shifted into supply industry. When built, this large geographically decentralized supply industry was a kind of political guarantee for the high extraction rates that evolved from the mid 80s. While successful in many ways, these developments have now caused the Norwegian oil and gas extraction rates to become unsustainable in the long run.
the largest number of tenders, being an operator in a number of oil-and
gas-fields and in the construction and maintenance of a number of installa-
tions for the extraction and supply of oil and gas from the North Sea. In
quantitative terms, Statoil alone has in recent years procured for more than
NKR 100 billion annually and it is linked to 25,000 suppliers (Tronslien,
2008). It currently holds about 80% of the value of all the operator tasks
at the NCS. Most of the value of goods and services it has procured has
been acquired through international tendering. Despite Norway’s member-
ship in the EEA with its regulations of cross border bidding, more than
80% of the goods and services have nevertheless been acquired from
Norwegian suppliers – at least until recently.

The high rate of oil and gas extraction in the NCS that has taken place
since restrictions on it were lifted in the mid to late 1980s, has also
contributed to the accumulation of procurement experience. The number
of projects has stayed high over a long period.

In addition to its various regulatory capacities, the Norwegian State is in-
volved in many of Statoil’s projects and fields as a passive owner through
its SDFl shares and as majority shareholder in Statoil itself. Yet, the state
as such is not involved in active procurement in the oil industry. As
mentioned earlier, it is the calculated SDFl-share in the operators’ costs
that make up the state procurement share in the oil industry, but since
it is the operators, particularly Statoil, who are making the decisions, it
is they who should be studied when seeking to understand the procure-
ment mechanisms in the oil sector.

The procurement rules that Statoil – and sometimes Statoil and Hydro
and StatoilHydro – follow may differ to some extent from the ones in
the public sector proper, particularly regarding the initial public transpar-
ency of the tenders. Yet, since most of the governance issues that arise
in Statoil’s procurement management are the same as in the general
public procurement, a model experience from the oil industry will be
used here as a kind of benchmark to highlight governance issues in
general. The two share a sufficient number of features, while the differ-
ences between the oil industry and the general public sector tendering
could be quite informative.

2.3. Governance Risks in Oil Industry Procurement Bidding

The procurement rules that Statoil – and sometimes Statoil and Hydro
and StatoilHydro – follow may differ to some extent from the ones in
the public sector proper, particularly regarding the initial public transpar-
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could be quite informative.

73 In 2008, investment in this sector was NKR 124 billion (Statistics Norway, 2009: 329). According to its own statement, StatoilHydro spent NKR 104.1 billion for its developments on the NCS in 2008 (Gunnar Myrebøe, Projects, StatoilHydro, power point presentation at ‘Offshore energikonferanse, 10 February, 2009). When the SSB statistics of the aggregate public procurement by the oil sector’s “General government enterprises” are compared with the “Statoil group procurement,” the latter is found to be consistently higher. For example, when in 2005 general government enterprises procured for NKR 54 billion, the Statoil group procured underwater installments and other goods and services for 63 billion.

74 On February 8, 2010, the online edition of the newspaper Dagens Næringsliv reported that the Norwegian company Aker Solutions has lost a major contract (NKR 6.9 billion) to the South Korean Hyundai Group. Operator in this case is ENI Norge, not StatoilHydro. Two other major contracts where BP is operator are expected to go to foreign enterprises (Dagens Næringsliv, February 2, 2010). Altogether these three contracts constitute a large share of the planned developments in the NCS and may signal for a significant shift in policy, to the great worry of Norwegian supply industry. For once, international bidding rules and/or their manipulation have become a matter of intense public discussion. There are claims about illegitimate Korean subsidies and a corruptible Italian contractor (Klassekampen, February 9, 2010).
As stated in the introduction, corruption is an important underlying governance issue in procurement. Even when rare, the precautions taken against it have become important determinants of the evolution of procurement rules adopted and the penalties for violation of these rules. While the established cases of corruption in the oil Norwegian industry are almost as rare as for public procurement in general, cases from the early 1990s show more systematic forms of economic disloyalty in the industry’s procurement activities than elsewhere. The number of scandals has decreased, but this may be due to deliberate impression management where company agents involved are moved from security to ethics and information departments in the company.

While some significant changes have been made in the institutional arrangements, the experiences from the 1990s still carry valid lessons. Moreover, the motivation has remained the same: large gains are at stake and complexity makes monitoring difficult and corruption easy to hide.\(^75\) The basic data on these past events are based partly on police investigations, and partly on investigations by the security departments of some oil companies. The police in the UK (the Serious Fraud Office) once got access to exceptionally revealing papers in the early 1990s through a successful sting operation followed by an equally successful raid of the office of the information broker Joseph Szjrajber. The papers led to the discovery of a number of related governance malpractices in the oil industry in the UK and in Norway.\(^76\) A court case against Szjrajber and another information broker, Sorelli, followed. Given the large number of contacts and contracts they had tried to influence, the exposed pattern of corruption and industrial espionage risks in the bidding processes proved more systematic than previously believed. This picture was confirmed by a systematic monitoring of the petroleum industry by a police unit located in Stavanger (the major oil industry city in Norway) in close cooperation with a special anti-corruption unit in Statoil.\(^77\) That police unit was divided into two parts and located under a centralized economic crime unit (Okokrim) located in Oslo.\(^78\)

In both the British and the Norwegian offshore sectors, the oil activity is organized into territorial blocks or fields that are leased, normally jointly, by a group of oil companies. A lease grants the group the exclusive rights to exploration, development, and production within the field. If a field

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\(^75\) In the sections below, the roles of illegal information brokering will be highlighted. Illegal selling and buying of bid documents is documented in many instances recently outside the oil sector.

\(^76\) A more detailed description may be found in Norwegian in Andvig (1994). A good, brief account may be found in *The Independent*, August 25, 1996.

\(^77\) The following model description and analysis is based on Andvig (1996) while new examples and some institutional innovations are recorded. The analysis in Andvig (1996) was based on access to some of the information collected by the police and some of the oil companies’ own security units.

\(^78\) Part of this process is recorded in Valde (2006). It could be surmised that part of the reason for the change was to have better political control over the cases that reached the public. From a corruption prevention perspective, the Stavanger police set-up is quite interesting since it was focused on the oil industry and monitored the constructions, gained technological know-how, and gathered rumors that prevailed within the industry. While for legal reasons few were brought to court, the industry knew it was closely watched which presumably had a preventive effect. Without fairly detailed knowledge, it is unlikely that the police may play a proactive role on corruption prevention.
within the Norwegian sector is to be developed, large scale construction is normally needed, although the typical projects recently tend to be smaller. The typical costs for an oil production project used to be around NKR 10 billion, while a typical natural gas pipeline system could be around 40 billion. As the new oil and gas fields and energy sources have become smaller and much of the infrastructure is already available, current projects decreased in size, compared to the mid-1990s. Yet, the aggregate nominal value of the Norwegian oil industry’s procurement has almost doubled, though it displays large yearly variations and without new large discoveries it is likely to decline in the near future.

In addition to size, interdependence is an important feature of off-shore investment – the return of any given installation is not independent of whether neighborhood investments have been performed. This creates complex patterns of cooperation and competition between the state and the different enterprises involved.

Many of the most well known forms of economic disloyalty in the oil industry are due to compromises of the confidentiality of bid information (the same applies to public procurement in general). Before any technology is installed, a number of licenses for exploration and extraction have to be granted/received but their granting is based on ministerial discretion. Still, there are no known corruption cases for this kind of decision at the Norwegian shelf despite the enormous economic value involved. Paradoxically, it is exactly the value that could explain the absence of known corruption cases – in such case, bribes would simply be too risky despite the complexity and opacity of the decision sequences involved. The downward pressures on the lower ranking personnel would be too strong, and the size of the organizations involved would be so large that corruption would be unnecessary.

Lobbying instruments become therefore more suitable. The situation where the political authorities had something so valuable to grant to business enterprises made the political contacts of the latter very important. Furthermore, the fact that Statoil have had such a dominant position in the oil business lobbying made free-riding issues less important than for other sectors and lobbying easier to organize (Olson, 1965). Yet, when operating abroad, Statoil has bribed in order to get shares in exploration licenses.

Once licenses are granted, and plans developed, procurement activities may begin. A procurement process starts when the project organization defines a certain task that needs to be accomplished or certain kind of equipment that is needed. Then a large number of suppliers deemed competent of delivering the goods or services are scrutinized. When

79 Somewhat surprisingly, Norwegian authorities still do not arrange any “highest price” auctions for these licenses although these would correspond to “lowest price” tenders in procurement. The discretion apparently is based on technological and, more recently, qualitative considerations of how competition in the Norwegian oil industry should be stimulated. Ostensibly for achieving the latter, an important feature of the later rounds has been the granting of licenses to many smaller companies. In a critical book about the Norwegian oil industry, Ryggvik (2009) claims that these firms are more like betting companies (betting on oil prices and oil and gas discoveries) than technologically sound corporations.
the task has been more precisely defined, or the desired properties of
the equipment more clearly formulated, the list of potential suppliers
becomes drastically reduced to a "bidders list", usually narrowed down
to 3-5 potential suppliers. Firms that would participate in the sealed
bid tender usually receive a very detailed bid invitation. The number of
potential suppliers cannot be too large at this stage because they are
expected to cover the costs of bidding which for complex tasks could
be considerable. If the number of potential suppliers becomes too large,
the expected probability of winning the contract becomes too low to
make it worthwhile to formulate a bid. If a large number of bids were
actually developed, it would become too costly and time consuming
for the project organization to evaluate them carefully. If the bidders
list becomes too narrow, however, the element of competition will be
removed. More recently, the search costs in the prequalification process
have been reduced in StatoilHydro (as is the case in the oil industry in
general) through the use of standardization enterprises such as the global
Achilles company with its local Norwegian oil industry office that issues
qualification certificates.80

A main cause for the companies joining forces at any given field is the ex-
treme economic and technical risks involved. As described above, for the
petroleum sector this means that one petroleum company becomes the
operator for the group (that is, the company acquires the main responsi-
bility for developing the field operatively). It holds the main responsibility
for developing technical concepts, organizing the necessary procurement,
making the major employment decisions, and so on. At present Statoil-
Hydro has, by far, the largest number of operator tasks. Consultations with
the other companies within the group are obligatory for all major procure-
ment decisions before they are implemented. This implies, among other
things, that what is considered sensitive and secret bid information often
has to be sent to five or six other companies, in addition to the operator.
Although the companies try to control the access to this information,
several persons inside each company are likely to have access to it. This
is, of course, a major difference between the procurement organizations
in the oil industry and other sectors. As a shareholder in most fields, the
state will also receive part of this information. In addition, summarized yet
important bid information is sent to the regulatory bodies.

An important consequence of these forms of cooperation is that it be-
comes extremely difficult to keep sensitive bid information secret. There
are clear limits to what can be achieved through strict secrecy codes
inside the operating company. Since a passive company of one field is
often an active operator in another, a mechanism for exchange of sensi-
tive information about suppliers is established. This information could be
used to organize various forms of monopolistic actions, i.e. the com-
panies might use their market power, their knowledge of the suppliers’
temporary shape of supply curves, to adjust their speed of buying, their
profile for buying, etc., in order to bargain for lower prices.

80 This company also monitors some of the procurers on behalf of the suppliers. It operates in a
large number of countries (about 20) and specializes in sectors – such as construction, mining,
oil and gas, utilities and pharmaceuticals – with governance risks. According to its own web
page, it was created in 1990 as a development in the Norwegian oil and gas industry.
2.3.1. The Risks of Project-Based Organization

The operator usually establishes a project-type organization for the development of a field. This project organization is a temporary simulation of a centrally-directed organization, where the project leader has extensive decision making powers. When the development of a field is accomplished, most of the project organization is terminated, and most of the remaining activities are directed by the parent company in a routine manner. The core of the project organization usually consists of regular, long-time employees of the operating company who are transferred to the project.

Organizing procurement on a project basis carries a number of disloyalty risks:

- The tasks and size of a project or procurement organization change drastically over time. Such a development follows logically considering the project’s short life: a small organization at the beginning and at the end, but a sizeable organization in the middle of its operation. The introduction of the so-called New Public Management (NPM) in an increasing number of public sector areas in Norway makes this form of organization, with its related governance issues, applicable to public sector as noted in the introductory sections of this report.

- In order to accomplish its tasks, the operator must be able to set up a complex cooperation mechanism between employees hired from a number of different firms. The operations of the project range from ordinary buying and selling to forms where the supplying companies temporarily become a part of the hierarchy of the operating company. The latter is often the case when the operator does not have the technical capacity to control the development. The operator then has to hire the engineering capacity of a large international engineering company (now also Norwegian companies like Aker-Verdal) as a main contractor of the field working on behalf of the operating company. Such companies have a larger stock of technological experts on development than a single oil company can afford to have in-house on a permanent basis. The shift towards project organization could cause the in-house expert pool to drop below optimum levels thus increasing the risks of accidents as has been evident in the discussions of the blow-up in the Gulf of Mexico.

It is obvious that the main contractor has weaker and more short-run financial interests in the outcome of the development than the petroleum company operator. Moreover, the main contractor may also have pure supplier interests as well as being a rented procurer. This has sometimes been a major problem with consequences for loyalty in the organization of the project for which the operator is assigned the major responsibility. The size of the technological tasks of any given oil company varies strongly over time. Since it is difficult to control such projects when not in complete control of the technical knowledge, various possibilities for economic disloyalty arise. Corruption involved in the Snøhvit project (outlined at the end of this section) is a case in point.
Even if the role of time planning for the management of projects is sometimes exaggerated (Turner, 1993), it is clearly an important characteristic of project development in the offshore Norwegian oil industry. The activities of any large public infrastructure project need to be strongly coordinated over time in order to avoid wasteful delays. The strong organizational pressure to complete each task in a given timeframe will often influence the market situation in the factor markets of the oil industry. This makes information about the time structure of demand and supply conditions extremely valuable. This is reflected in a well-known case in the oil industry from the mid-1990s. There the German steel company Mannesmann bribed a civil engineer in Statoil to delay Statoil’s orders for steel pipes so its Japanese competitors that needed longer delivery time, would be unable to supply. Hence, Mannesmann could be sure to both get the contract and charge above market prices.81

Another important characteristic of the organization of projects that is related to the preceding one is the strong linkage between tasks. This applies both at the planning-design level and at the operating stage and could cause the time pressure already noted. In addition, it implies that the technological choices made at one stage of the project may determine the range of choices to be made at a later stage. In addition, task choices made at an early stage may cause certain suppliers to become a (temporary) monopoly at a later stage. This may also provide incentives for a supplier to bribe or influence the operator’s choice of engineers early in the bidding stage where the company is not directly involved, making it exceptionally difficult to locate any improper influence.

Early on, the oil industry adopted sealed bid tendering for almost any kind of procurement. Already in the 1990s, Norwegian-based oil companies stipulated this method of procurement even for small purchases of about NKR 1 million. In many situations sealed bid tenders are clearly justified, but the principle is often mechanically introduced and not chosen on the basis of strategic considerations. This has spread to the public sector in general and today tenders are required for purchases above NKR 500,000.

In principle, when the tender invitation is published, no exclusive communication between the project organization and a potential supplier is allowed to take place. For example, if a supplier needs explanation over ambiguities in the bid invitation, the same explanation has to be sent to all the bidders. All bids have to be delivered in sealed envelopes within a very specific timeframe. Further, the envelopes should all be opened at the same time at a carefully scripted meeting where the officials allowed to attend are specified beforehand.

After the bid-opening meeting, the bids are compared and evaluated by experts hired by the operating company. It is customary to split the evaluation team into at least two independent working groups: one eval-

81 The story received considerable attention partly because Mannesmann had been involved in a number of other bribing instances. In the end, the company sent a representative around to a number of oil companies working in the NCS to apologize for its behavior, including Statoil and Hydro.
uates the financial aspects of the bids, the other the technical aspects. While the first group primarily relies on in-house expertise, external consultants are frequently hired in the technical evaluation process. The groups work under considerable time pressure. The two groups do not share their decisions with each other. In particular, the technical evaluation team(s) does not know the financial details. The evaluation results are then combined in an overall evaluation, and a formal decision about the winning bid is reached. When it comes to the final procurement decisions of the operator, Statoil has recently emphasized the importance of having a clear division between the roles of the line management and the procurement function.

Even after a supplier is chosen, the other competing companies have no right to know any details about the prices and technical solutions of the winning bid. Furthermore, often there are rules within the operating company that forbid further bargaining with the winning supplier. However, many details need to be further specified and it is difficult to believe that these rules of no post-bid-opening bargaining are actually followed. Therefore, a regular sealed bid tender in the petroleum industry is concluded by detailed negotiations with the winning company and more general negotiations with its closest competitors. The results of the negotiations with the winner will normally be kept secret from the competing suppliers. An important property of the formal bid process is the extensive control of information. In particular, it is striking how limited is the information that potential suppliers have the right to know, not only before, but even after the bid opening has taken place. Hence, it is not surprising that some corruption is due to suppliers trying to overcome the information asymmetries built into these procedures.

Considered as a sealed bid auction, the procurement processes in the oil industry has a mixture of specific and common characteristics. One the one hand, part of each supplier’s cost function is fairly well-known and depends only on the supplier’s individual characteristics. Other parts, however, are quite uncertain and will depend on factors that may affect any company, such as weather, steel prices, industry-wide strikes, task complexity, and so on.

The suppliers may have different independent assessments of the size of the likely implementation costs. The one with the lowest estimate will present the lowest bid and possibly win the contract. Yet, as the lowest estimates are likely to be wrong, that supplier may easily lose in other ways – by being plagued by the so called winner’s curse. Suppliers, of course, will be aware of this danger, and may try to avoid it by building in extra profit margins. This again may lead to paradoxical outcomes. For example, in procurement tenders the suppliers may increase the price if the number of competitors increases, since the lowest bidder then knows that their cost estimate is more likely to be too low. Hence a higher profit margin is necessary to protect the lowest bidder against the risk

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82 A concept in economics where the winners of the so called common value auctions underestimate the project costs and hence formulate a bid so low that will lose on its implementation. For a fairly accessible discussion of various forms of auction including the winner’s curse problem see chapter 11 in Binmore (1992).
of a winner’s curse.\textsuperscript{83} Gaining access to the other suppliers’ estimates of common cost factors is another way that risk may be avoided. Risk avoidance should thus explain some of the reasons why bidders have strong incentives to buy bid information illegally. This is the case for any complex public procurement project, but is especially pronounced in the petroleum industry due to both the large size and organizational complexity of its investment projects and the likelihood of exposure to the same exogenous shocks (e.g. extreme weather conditions).

2.3.2. Tender Sequencing

One aspect of this complexity is the sequencing of the bidding process in which the outcome of the tender at any given stage will be determined by the outcome of the preceding stages. The project management cannot then analyze any given bidding in isolation. Instead, it needs to determine the complex of activities considered most beneficial and treat them as a unit in a bidding process, leaving the further specification of tasks to be tendered out by the primary bidders. The range of possibilities is considerable: for the extraction of oil from any given licensed field, for example, the operator considers whether a steel production platform, a concrete platform or rather a production ship is the best solution. It may suspect that a production ship would be the best solution, but if it tries to organize it as sequence of tenders in order to maximize competition, a hold-up could result (e.g., at the buoy construction stage, if there was only a single competent supplier for that construction) if that sequence were to be chosen. In order to elicit a competitive bid from that monopolist, competition has to be introduced at an earlier stage, where the bidder for the whole production ship construction package has to make a deal with the buoy constructor beforehand so the procurer could reckon whether that is competitive with, for example, the steel production platform option.

The packaging of a development project into some (or many) sequentially determined sealed bid auctions will have important consequences for the forms of economic disloyalty to be expected. The strategic task of determining the packaging structure, for example, opens up considerable possibilities of maneuvering specific suppliers into different market positions. With larger packages, information becomes less specific and harder to sell, and decisions have to move upwards in the hierarchy. This implies that corruption possibilities directly connected to a specific bidding become less relevant, while the scope for corruption and embezzlement during the later construction process is likely to increase as the number of potential delays increases.

2.3.3. Information Brokerage and Industrial Espionage

So far the discussion has mainly focused on the interaction between the operator and a set of potential suppliers. Another set of specific

\textsuperscript{83} In addition to Binmore (1992), good and exceptionally accessible introduction to some of the major research issues in auction theory, also providing a definition of private and common value auctions, can be found in Milgrom (1989).
circumstances of the off-shore petroleum industry is the operator-license
partners relations that have evolved in order to share the large economic
risks involved in the development of oil fields. That is, a number of en-
terprises and public authorities will share the costs as well as eventual
income that accrues to the field. This relationship implies that there may
be a set of enterprises and organizations that have access to at least part
of the information in the sealed bid auction.

Much of the middle-level corruption in the oil industry has thus been
connected to illegal activities of the so-called information brokers.
These are a set of private agents who package information about likely
developments in the industry for suppliers and other interested parties.
The illegal bits are collected when they are able to buy bid informa-
tion from employees in the oil companies (operator or partners) and
sell it illegally to one or several suppliers. If brokers succeed in gaining
information in this manner, the breach of trust by employees would be
a problem for any organization, but the further consequences for the
procuring enterprise depend to a large extent on how the market for bid
information is organized.

Information brokers would know the distribution of the bid prices and
are likely to gain the most if they sell this information to the lowest bidder.
In fact, the most commonly observed behavior of information bro-
kers seems to follow this pattern and is called the “uplift”. The informa-
tion broker sells the information to the lowest bidder, who then is able
to renegotiate their price upwards just below the second-lowest bid (to
make an uplift). If this is done systematically and every supplier knows
about it, the auction is in practice changed from a “first-price-sealed-bid
auction” to a “second-price-sealed-bid auction”, also called a Vickrey-
auction after the first economist who studied this situation analytically
(Vickrey, 1961: 22). In this situation, everyone would make more daring
and lower bids since they know they would receive as much as the sec-
ond lowest bid. In fact, the procurer would pay the same as they would
in the case of an honest sealed lowest price bid auction. Moreover, from
the point of view of the public good, this will be an efficient solution,
since the most efficient supplier will win the bidding contest.

On the other hand, if the information broker is selling price information
to all suppliers, the motives for buying price information would change.
If brokers do that, the auction in practice would change from a sealed
bid auction to an open “English” auction. Yet, why would anyone pay
for information in this situation? If all suppliers stay uncoordinated, they
would not be willing to pay much for this information. If the lowest bid-
der tries an uplift, every supplier would know about it. The upward bar-
gaining would be difficult to implement without a complaint and a bribe
difficult to conceal. The situation as a whole would not change much
from a sealed bid auction. This outcome – that these three different
auctions should yield the same result (although two here rely on corrup-
tion) – is known in the literature as the “Revenue-Equivalence Theorem”
(RET). An English auction is open to the so-called bidder rings, in this
case a cartel among the suppliers. An information broker may in fact
be the organizer of a cartel without having to be aware of it himself.
the broker sells the information to every supplier, the suppliers will then
know the bids of the others and discover whether anyone is breaking the
cartel agreement. As an organizer of a cartel, an information broker has
a strong incentive to hide his/her transaction from the authorities. Since
it is corruption that allows brokers access to the necessary information,
the strictly economic consequences of corruption will in this case be
harmful to the procurer.

Given the extent and kinds of technological uncertainty, it is not possible
to infer the likely costs of a project only through information about the
bids of competitors. Bad weather, an early winter, industry-wide strikes,
etc., may harm any supplier’s cost function. Thus, as mentioned above,
there is an element of the winner’s curse in the bid structure. The sup-
plier with the lowest bid is likely to win the competition. This becomes
most important when the differences in efficiency between suppliers are
small, while the common technological risks are large.

Bid information has, however, also technical aspects that are often col-
lected separately from the price and cost information. For the com-
munity of the North Sea developers, with its heavy engineering basis,
the technological solutions to problems are commonly considered more
important than prices for awarding a contract. The same applies to any
technologically complex and large public procurement project. Each auc-
tioned construction task consists of many technological solutions and,
normally, a supplier will be positioned to solve some of the problems
better than the others. The decision-maker who is tasked with choosing
one of the bids has to set an implicit economic value to each solution,
which is compared to the price information, in order to rank projects
and pick a winner.

If the technological information could be easily understood, assessed,
and evaluated by all participants using the same preference scale, not
much would change from the situation where only price information
is collected. Bidders would have to consider only whether it is more
profitable to change to a better technological solution, rather than re-
ducing the price, in order to rank higher up in the competition. While
mostly correct, this scenario clearly underestimates the difference that
technology makes: if a supplier has found a good solution of a recur-
ring problem, this may give this supplier a competitive edge not only
in the particular bidding, but also in future tenders. Because of this
edge, the discounted value of the solution may be high. If the solution
is illegally sold to the supplier’s competitors by an information broker,
the competitive edge is lost and so is its economic value. The value of
buying the information would be considerable for the competitors, as it
increases the probability of winning this and future tenders. In addition,
such information has a more clear-cut economic value to most bidders
than the price information, which depends more on the particular posi-
tion of suppliers on the market. Furthermore, if information brokers are
mainly selling bits of technological information – after buying it from oil
companies’ employees – the pattern of mainly selling the information to
the firm that seems to be ahead in the competition (the uplift) should
be irregular. **In other words, the industrial espionage aspects of the
information broker’s bribing activities may be more important than their illegal collection of price and cost information that mainly deals with the winner’s curse problem.

In practice, the preferences of the participants with regards to technological solutions are not likely to be similar. Thus, a bidder with insider information about the procurer’s preferences for technical solutions has an advantage unrelated to the economic and technological efficiency of the bidder. More importantly, to assume that technical information can be transmitted as easy as price information, is quite unrealistic. Often only a few persons within each company are able to assess and evaluate any given piece of technical information. In addition, such information has to be transmitted several times back and forth between employees of different organizations in order to be properly understood at the level of specificity needed. This fact implies that if technical information is to be sold to a competing firm illegally, it has to be transmitted to the few persons within the firm who have the proper knowledge. Those persons, however, are not authorized to make payments to acquire such information. This suggests that if a bidder is to buy technical information, either their organization has to be more closely engaged (compared to situations where they buy price information only), or the management needs to hire external consultants for this purpose. In any case, the management of the supplying companies is very likely to be involved. The buying of this kind of information cannot be delegated to professional sellers or agents making the risk of exposure much greater.

People who have the same level of technical competence, and hence often the same values, will be employed in different firms. Some will be employed by the operator and its consultants, others by competitors. Due to their common interests, experts tend to create networks and share (sometimes leak) information that may be against their employers’ immediate interests. This tendency to create networks is reinforced by the post-bid work organization of the operator: the fact that the operator needs to coordinate consultants and employees from a number of different firms. Technical experts who are employed by the oil companies on a short-term basis will often consider these informal networks as a more important reference group than their company. The exchange of personal favors through these networks (e.g. hiring consultants on the basis of friendship instead of competence) is more likely to become a serious problem than financially motivated corruption. The extensive use of consultants in public sector activities and other forms of outsourcing of public services have increased the importance of shared-value networks, which are now criss-crossing the Norwegian public sector and influencing public procurement decisions.

As mentioned, when technological information can be illegally bought and sold, corruption is mixed with industrial espionage, a serious governance issue when procuring large constructions with embedded complex technology. There are, nevertheless, interesting variations. Comparing procurement in the oil industry with public procurement in general, transparency demands in the general public sector may ease industrial espionage. On the other hand, the shifting roles of companies in the oil
industry – the tendency of companies to switch between being a supplier and being a procurer – makes it more difficult to solve the espionage problem in this industry. This is compounded by the fact that the main procurers in the industry, particularly StatoilHydro, have strong interests in protecting their own technological knowledge, including knowledge acquired through research support. The efforts towards international expansion increase the incentives for protecting this knowledge and its economic value. Moreover, the existence of several license holders to the same field ease the potential access to sensitive, technical bid information in the oil industry.

From the viewpoint of the public good, the ease of (illegal) access to technological bid information may facilitate the transfer of technological knowledge in the petroleum industry, which may be a socially desirable outcome, but harmful to the petroleum industry’s suppliers. In public procurement, fear of industrial espionage could cause more harm than its direct effects. In many cases, fear of industrial espionage makes it difficult to organize competitive and transparent tenders, since the detailed ex ante bid information could be transmitted to the competitors. To protect against this, the ex ante bidding may become somewhat pro forma, while the information would be revealed for the first time only after the supplier has been chosen. In this case, it would be difficult to determine whether the supplier has used non-competitive methods when gaining a contract or, for example, bribing may have been involved. In the end, the fear of industrial espionage could lead to tenders being formulated loosely thus making a variation of the cost-plus form of contracts the dominant contract form.

If oil companies and public procurers treat all bidders equally, do not try to renegotiate with different suppliers after the bid opening, and treat the bids as unchangeable, the only sensible motivation for selling or buying secret bid information would be for industrial espionage purposes. Thus, the outcome of the competition itself will not be influenced. The presence of information brokers, who acquire information illegally, shows that the procurers may not be strictly following the rule that forbids post bid-opening renegotiations. In a kind of guide to international selling that also could apply to the oil industry Marsh (1989: 31)\textsuperscript{84} underlines the following:

“Experience suggests however that few clients or their consultants actually proceed in practice the way in which Horgan [Horgan has written a well-known handbook about how rule-abiding tendering should be performed] proposes. Even if the tenders are discounted to give their net present values, financial offers appraised and financial comparisons made of the technical merits of each bid, it is naive to believe that this will not be followed by requests for reductions, revised offers or even a ‘Dutch Auction’. The important point for you to appreciate in deciding on your chances, is the difference client behaviour will make to you in relation to your competitors.”

\textsuperscript{84} While it would be impossible to write a manual like this today due to shift in public company norms, the actual practice may not be that different. For example, in the known cases where Norwegian oil industry has been involved in bribing foreign authorities, middlemen have been involved.
What Marsh is suggesting is that a bidder should develop a two-stage strategy for two interlinked auctions. The first one is officially a sealed bid auction but, in practice, through the intelligence networks likely to be developed by each supplier, it resembles an open English auction, except for the fact that decisions are not made at this stage. In the second stage, which officially is not taking place at all, a multi-stranded but in the end bilateral bargaining process takes place. Here, the suppliers’ intelligence systems break down, and they would often not know about the offers of competitors. This process may to some extent be a real first-price-sealed-bid auction. It is during this auction that the eventual intrusion of an information broker could become important.

2.3.4. The Buying and Selling of Award Decisions

The corruption mechanisms discussed so far are rather indirect. Decisions are influenced via illegal purchases of information relevant to the award decisions. A more direct approach would be for a supplier to pay the organizer(s) to decide in his/her favor. Behind the smokescreen of technological complexity such an action might not be so easy to detect. If petroleum companies succeed in their common goal of restricting the access to bid information, the number of employees who are in a position to know about and control such illegal sales of decisions would obviously decrease. This, in turn, would make it easier for the persons involved to sell their decisions. In terms of good governance and anti-corruption policy, there is a trade-off between reducing the illegal sale of information or the sale of award decisions. Evidence about sale of decisions is more scarce and difficult to identify because, as will be noted later, information brokers may have strong incentives to pretend that they actually influence decisions when they only have information to sell.

In the economics literature there are several analyses of purely corrupt bidding auctions where the successful bidder is the one who pays the highest bribe. Again, this might be done as an open English auction where everybody is made aware of the size of the other bidders’ bribes – a rather unlikely procedure except in highly corrupt environments. A sealed bid auction, where the suppliers do not know the size of the bribe proposals of competitors, is more likely. It is easy to show that the most efficient producer will win the bribe. The only major effect is that the whole producer surplus is transferred from the supplier to the organizer of the auction, who now has an interest in seeking the most efficient supplier (Beck & Maher, 1986: 1, Lien, 1986: 341). An interesting policy conclusion follows that it is the suppliers as a group, not the oil companies, who would have the major economic interest in eliminating this form of corruption.

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85 This section does not discuss the situation where the top management at both sides of the transaction are involved, the procurement of a construction has already been decided at this level, and where the whole procurement auction itself is just a façade. This is probably more common in public procurement where politicians are involved. Note that the reason why StatoilHydro has moved the procurement administration outside the chain of command was to make informal dealings with top leadership more difficult.

86 Section 2.7 will outline more recent and complex economic analyses of corruption in bidding systems when bidders come from national environments of different corruption propensities.
2.3.5. Post-Bid Corruption and Embezzlement

Both corruption and embezzlement may occur at the construction stage, after the bidding process. The most serious form concerns variation order decisions. Due to the technological complexity, it is impossible to specify beforehand all tasks involved in a given contract. Thus, an important part of any bid is to specify standard prices for standard additional construction tasks. In many cases, most of the profits earned from any contract will come from such additional work. However, some forms of additional work should also be expected due to the supplier's mistakes or miscalculations for which no extra payment should be forthcoming. If this additional work is classified as being beyond anyone's reasonable capacity to foresee, the supplier will receive a variation order and receive extra payment from the procurer. In a simple case, the supplier may bribe the decision-maker on the spot in order to get this classification.

It was in fact an attempt to get such additional work classified as a variation or change order which triggered the series of court cases that exposed the illegal information broker system in the North Sea oil industry to the general public. A small engineering firm that was involved in the building of a petrochemical plant in the U.K. got into economic difficulties and attempted to influence an engineer from Exxon to (re)classify some works worth $130,000 as a variation order, by offering him a bribe worth $10,000. Partly by coincidence, one of the larger information brokers in the North Sea, J. M. Szrajber, participated in the meeting in the hope of recruiting the engineer as his permanent agent inside the oil company. Instead, the engineer exposed the plot to the police who was able to raid Szrajber's offices.

Information brokers are not ordinarily expected to transact such simple variation order deals. The most lucrative manipulation of the bids that information brokers may engage in is when they are able to deliberately keep some reasonable specification of tasks outside the tender. Then it becomes possible for a bidder to lower their price, increase the chances of winning and gain through the later change orders. If the supplier wins, he/she will receive payment for these left-out tasks, as they now have to be classified as variation order work. This is a rather demanding form of information manipulation which is highly rewarded. The rates in the mid 1990s were 10-15% commission for a variation order manipulation vs. 2-3% on other work. There are many possibilities for embezzlement combined with corruption at lower levels at the construction spot. A sub-contractor may, for example, claim more hours spent on a task than actually used and bribe the contractor's person in charge into approving these claims. Embezzlement of this kind, however, is not what information brokers deal with. This form of corruption is more improvised, but it is easier to implement when a number of enterprises are working on the same spot under a project leader.

2.3.6. Breaching Procurement Rules: A Summary

The particular incentives and possibilities for an illegal trade in information and decision making are by themselves an economic activity that
needs to be organized if it is to be on a sizeable scale. The corruption tied to public procurement in Norway is unlikely to have reached this scale, except for some time periods in the development of the oil and large-scale construction industry. Nevertheless, when it occurs it provides clues to the organizational problems that those who cross on the other side of the law are likely to encounter. Moreover, new insight into the governance issues in procurement in general – for example, how the agents try to overcome the considerable transaction costs involved may reveal information about the profitability and its rate of incidence – could be gained.

There have been three basic ways of organizing corruption in the procurement of the Norwegian petroleum industry. In the simplest case, the owner or a regular employee (usually in smaller firms) of a supplying enterprise bribes an employee of the procuring organization to make a decision or give some information in the supplier’s favor. Since sealed bid auctions are more extensively used in public procurement (and in the oil industry) than elsewhere, these activities may have some particular forms and may at times be more difficult to implement than elsewhere.

Larger supplying firms may be involved if they decentralized the sales to professional sellers, who receive a considerable part of their pay as commissions, but are still employed by the supplier. These people will only be able to pay bribes in the case when they win the contract, since they usually have independent budgets. Their incentives to pay out parts of their commission as bribes may be strong, however.87

These active sellers shade into the class of tied middlemen, usually called agents or consultants. They are legally independent of the supplier, but agree to represent him/her in a given transaction, market, or location. Marsh (1989: 46-48) describes them in the following way:

“Regrettably, it’s a fact of business life that the path to a firm’s success in obtaining a contract has so often to be smoothed by favours done to those in a position to influence or decide upon the direction in which the award should be made. Since it is normally impractical, and certainly undesirable for you to become directly involved in the distribution of such favours, the services of a middleman become essential. […] Be extremely cautious. Cross check as far as possible an agent’s claim to access and influence. […] – Payment of his fees should only be against results, that is, you should resist any payments prior to contract award. […] The agreement should be for one job only. […] Maintain regular contact, always through the same person on your own staff.”

87 A major Norwegian case from the oil industry is well documented since it went to court with detailed report (“Referat fra Stavanger Byrett, 18/12 1992”). It dealt with two foreign employees of a Norwegian company who had bribed two employees of an American oil company in order to win a contract and perform an uplift, which they believed was in the interest of their company. Since the company was new in the specific field, they had understood that they were employed in order to do some hard selling. Accordingly, they sued the company when they were fired for being caught in bribing the employees of the oil company who were not fired. The court – located in the town where the Norwegian company in question was headquartered – confirmed the legality of firing people in this case.
The point with agents is that they reduce the legal exposure of the supplying firm. Since they are also mainly working against the representatives of a single oil company in a certain geographical area, they are likely to have much specific knowledge. However each agent can only be used at relatively rare occasions. Thus, an international supplier would need to establish a network of agents, all of whom are likely to have only localized knowledge, and who may be unable to combine the pieces of information necessary to determine the development pattern in a certain field in the North Sea. This network may often be quite expensive and not always useful. Given the nature of off shore developments, middlemen connected to the oil industry have to possess more technological knowledge and less understanding of the political processes than similar agents when dealing with public procurement in foreign countries.

In the Mannesmann case in Norway outlined above, Mannesmann as a large supplier of steel constructions had established a local agent in Stavanger that worked in the way suggested above. The company was not satisfied with the agent’s performance, however, since he had less influence than needed, so the company had bypassed him at several occasions. Hence, the agent turned whistleblower when the company side-tracked him and bribed the Statoil engineer directly.

In general, the advantage of an agent, compared to an independent information broker, is that an agent is more likely to be trustworthy, as he/she is likely to represent a single firm at a time, thus not simultaneously representing a company and its competitors. A local agent is also more trustworthy from the perspective of the employee of the oil company performing the illegal act, since the local agent and the employee are likely to function partly under the same jurisdiction. In addition to effecting the contact between the briber and bribed, the agent may also arrange the payment and assist in the money laundering. Otherwise, the agent’s ability to reduce the transaction costs is limited since the “insider” may only rarely be able to sell valuable information to any given agent.

The **information brokers** are different since they are independent agents who do not have any long-time commitment to any particular supplier. If an employee in the procurement agency is identified as corrupt, the broker may transmit that information to a number of suppliers. If a supplier of low quality construction is willing to bribe, the broker may even be able to find a number of procurers (more difficult) that may accept its offer for a bribe. In this way, the existence of brokers may cause a fairly large share of transactions to be influenced by corruption, although few employees in either the procuring or supplying organizations are willing to engage in it.

From an insider’s perspective, once beyond the threshold of legality an information broker can be used every time he/she has a valuable piece of information or influence. As just mentioned, a local agent may only rarely be used. When using a broker, the oil company’s employee does not have to engage in the costly and risky business of reaching the relevant employee of the relevant supplier. From a supplier’s perspective, the advantage of using an information broker is that the broker usually has
an established network of contacts in different oil companies and in different parts of the same company. He may then save the costs involved in creating an extensive network of agents. It is clearly advantageous for a firm to employ an information broker with a large network, since it could then use a single broker for many different assignments. This could reduce the disadvantage arising from the supplier having few methods to sanction information brokers if they are bluffing or deliberately producing wrong information, compared to employing local agents.

The main “value” of the information brokering is that brokers reduce the search costs at both ends of the illegal market for information and influence in the oil industry. Since these search costs are important for reducing the extent of corruption in low-corrupt environments, it is precisely at this point that the activity of information brokers becomes exceptionally harmful to the industry by considerably increasing the overall extent of corruption. Some information brokers seem to start their career as an insider of a procurement agency; others start out as local agents for suppliers. In both cases, the accumulation of larger networks is a precondition for starting a career as an independent information broker. Whether information brokering is a regular feature of public procurement processes in Norway

### Box 3. Corruption cases in the Norwegian petroleum sector

Not many cases of corruption have come to light since the 1990s in the oil industry in Norway so two are worth outlining.

**The Snolvit (Snow White) case** – named after the natural gas field in the Norwegian Sea – took place in 2005 – 2006 when a procurer for Statoil was involved in transactions accepting twice the regular price for a delivery of pallets from a local supplier. While the procurer received most of the surplus of the transaction (about 200,000 NKR) as a bribe, the agent of the supplier received a minor kickback. The procurer got a seven months jail sentence (Nordlys, March 10, 2009). What was interesting about the case was that the procurer had been hired by Statoil from its major Norwegian supplier, the Aker. The case reflects the divided loyalties that may arise during the construction of large projects, where market networks are often embedded in a short-term hierarchical structure, and procurers turn into suppliers and vice versa.

The other case was somewhat larger with higher ranking people involved. A Statoil engineer – responsible for the procurement of coating services – was sentenced to ten months in jail for receiving NKR 400,000 in bribes from two directors in the German firm Rheinhold and Mahla Industries (R&M) who got the contract. The R&M directors were also convicted and sentenced to eight and six months in jail, respectively. What makes the example interesting was that the same company had just been accused to have joined a cartel together with another coating firm during the period 2000 – 2002. The relationships between organized bribing and eventual cartel collusion are many sided and worthy of further examination.

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88 For more details on this see Andvig, 1991.
89 Whether the more recent decrease in scandals, compared to the 1990s, is due to improved management of the procurement processes by Statoil Hydro and other operators in the North Sea, or to more random events that exposed more cases to the public before, is not possible to determine on the basis of the available data.
is an open question, but their existence is necessary for corruption to have a sustained impact in low corruption environments.

With regards to the method of recruiting insiders, both agents and brokers seem to follow similar procedures of creating a friendly atmosphere. Great efforts are made to develop an insider who is then used repeatedly. Once the moral threshold is passed, the moral “costs” for the insider decrease and the selling of information to an information broker becomes increasingly easier. The very existence of a group of fairly rich information brokers, whose livelihood is based on the illegal buying and selling of information about the Norwegian oil industry, is indicative of bribery having been fairly common once. The way their behavior has become standardized also suggests the same. On the other hand, great investments in the recruitment of insiders, and the fact that one insider could be used repeatedly, even if other oil company employees are available for the same task, is a qualitative indicator that, even in the mid 1990s, the North Sea could not have been a highly corrupt environment.  

This section will illustrate some persistent governance issues in public procurement in Norway by way of describing several public exposures of corrupt transactions. At the outset, a structural overview is required in order to understand these cases and what they involve.

Most cases have become public through the interaction between whistle-blowers and journalists, sometimes followed up by the economic police and courts. Thus, such cases are better documented than those that have attracted less public attention. The instances where small volumes were involved are hardly newsworthy. Since it is extremely difficult to prove any wrongdoing among senior public officials and politicians, as pointed out by Rose-Ackerman (1978), large cases are also rarely exposed to the public. Moreover, public procurement rules are not likely to have any strong effects on grand corruption since these agents are able to manipulate the rules. The absence of publicly exposed cases of illegal complicity between a politician and a major supplier in Norway does not imply that it never took place but rather that most such cases have resorted to legal means. In Norway, one needs to look at the lower levels to find empirically documented cases of corruption in public procurement.

It is likely, therefore, that middle-sized cases would be overrepresented in the media. For the ones presented here, the development of more precise technical and economic pre-specification criteria could have reduced the risks. Even if a politician responsible for the policy area were to conspire with a major supplier, and the procurement officials are likely to pick up the relevant but vague signals emitted (signals too subtle

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2.4. Governance Failures in Procurement: The Evidence from Norway

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to leave any trace provable in court), the specification of procurement rules may increase the implementation costs of any corrupt transaction, without preventing it altogether. The ability of procurement officials to detect and respond to such signals will also depend on the administrative structure. In the case of Statoil, for example, the company employed bureaucratic methods to keep the procuring officials at a distance from the regular line structure – a typical Weberian device. This makes it harder for senior officials to directly intervene in the procuring activities or fire procurement officials without considerable evidence. The more receptive procurement officials are to signals from the political level, the greater the impact of politicians. When senior public officials make corrupt collusion with major suppliers, bureaucratic responsiveness makes those deals easier. On the other hand, if top level officials become more committed to anti-corruption policy, increased bureaucratic sensitivity will reduce its implementation costs, too.

In addition to bureaucratic separation, the ease with which officials are fired, promoted or demoted could be expected to increase their acceptance of high level signals for both unlawful as well as lawful behavior. It is a double-edged sword: the use of such hard incentives would make lower level administrators less willing to send signals upwards thus reducing the awareness of management and policy makers of corruption taking place at the lower levels.

A number of reasons which make public procurement in general a high corruption risk zone need to be outlined for a better understanding of the specific cases below:

- Most supply industries are characterized by a variation of monopolistic competition with increasing returns to scale. If prices were determined independent of output, each enterprise would like to sell more than it does if this would have no negative impact on the market price – it perceives itself to be in a kind of excess supply situation. A secret bribe could be seen as a form of price discrimination, where the supplier and the procurer share the spoils (the consumer surplus) when a monopolistic firm is able to discriminate between purchasing groups.

- A sizeable fraction of public procurement is connected to large and fairly heterogeneous projects which implies that fairly large amounts of money are involved. Eventual bribery is then difficult to detect and the amounts involved may be large enough to make more people trespass their moral thresholds for engaging in it. It could be surmised that the corruption income elasticity of these thresholds is higher than one; in other words, the income from corruption has to be quite high when the initial income of the agents is high. This means that it is only at extremely low detection risks and with high corrupt income yields that public officials would consider getting involved in corrupt transactions in a country like Norway. Public procurement contracts could potentially offer both.

92 A brief popular explanation of this aspect of enterprise behavior may be found in Weitzman (1984).
• The public sector itself is characterized by having a large number of objectives and being composed of fairly large organizations. This makes the public sector extremely difficult to monitor. Pockets of low activity units, including low activity monitoring units, may easily arise (Andvig and Moene, 1993). Corruption risks in transactions between departments in a traditional public administration are minor, since they are mostly bookkeeping units. Regular wage payments to public employees are so easy to monitor that they rarely give rise to corruption (except in the cases of extremely weak states where ‘ghost’ workers – non-existing officials – may join the budgeted workforce). With greater independence of the public service units, however, there will be more “hard” money procurement across units. That increases the internal corruption risks. Transactions which were formerly internal to a public organization start to resemble public procurement contracts where payment is in hard money. Such a development could be seen in Norwegian research environments and hospitals. Compared to regular wages, such payments are more irregular and difficult to monitor. With an increased emphasis on outsourcing and more extensive use of external consultants, the number of cash transactions difficult to monitor has increased in the Norwegian administration.

• As previously mentioned, public officials in Norway are allowed to have ownership rights in private enterprises.

2.4.1. Local Government Procurement of Construction Services

About a fourth of the value of public purchases in Norway (NKR 103 billion in 2008) is carried out by the local administration (kommuner). Their building, property, and land management is potentially the sector most frequently exposed to corrupt transactions, or at least the sector with the greatest number of corruption cases that have come to light. While the number of cases is not sufficient to make this proposition statistically significant, it appears that corruption risks are highest when municipalities entrust their procurement of construction and building maintenance services to separate, centralized enterprises operating commercially. To get a sense of the volumes involved, we may note that local (and regionally-owned) enterprises altogether procure for about NKR 16 billion annually. While most of these enterprises are not into property management, their share in the values procured is high.

All four characteristics, described above, played a role in the first of the two cases involving Undervisningsbygg, an educational building company which also fits the description of a property managing company. It is a company established and owned by the municipality of Oslo to manage

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93 Only publicly exposed cases are discussed here. In such a broad overview as presented here, it would be impossible to do the necessary research to make independent claims about whether corruption has really taken place or not. All the accounts in the following are based on research by serious prize-winning journalists. Since only the patterns that can be glimpsed from these cases are of interest to this analysis, the identity of the perpetrators is irrelevant and so is withheld.
and develop its school buildings. It has been given ownership rights to all the municipal school buildings and receives its income through renting them out to the school administration, which in turn charges individual schools. This arrangement was established in 2002 (Renå, 2009: 65), as part of the New Public Management (NPM) initiative in the Norwegian public sector that seeks to emulate private enterprise behavior in the hope of increasing efficiency. Undervisningsbygg invests about 1 billion NKR annually, mostly in contracts with the construction industry.

The first of the corruption cases of Undervisningsbygg was the largest one.94 It was initiated by an official, M., on the public sector side, who in 2003 became the manager of the property division, one of three divisions in Undervisningsbygg. The private companies involved played a fairly passive role. M. had recently moved into Undervisningsbygg from a private property management company where he was a technical division chief. He brought with him his existing network of building service firms when making his procurement decisions in the public enterprise.95 M. discovered that the control was less strict here than in the private company he had left, particularly with regards to framework agreements96 won by some of his old friends. During two years he was able to cash in NKR 90 million through accepting over-billed invoices. One way of skimming public funds was when some of the over-billing suppliers (who he knew beforehand) accepted fraudulent bills (limited to 8% of the value of the contracts) issued by a shell company owner-registered by a friend, but controlled by the official.97 This contact with a registered company was helpful mainly because it was a precondition for issuing false bills, but also in masking the transfers from the public coffers by establishing an intermediate transaction step before transferring the money to his private account. Yet, this was a rather crude way of masking the operations, thus leading finally to the exposure of the corrupt practices. The framework agreements made the discovery more difficult since the invoices were vague. They were also used when M. presented Undervisningsbygg with the purely fraudulent bills from his own shell company that he accepted himself as its procurement officer. This was, of course, pure embezzlement made possible by the fact that as a procurement official he had also been given the right to control payments.

Weak internal monitoring, both with respect to bookkeeping and tendering rules, partly explains why it was possible for this official to gain so much corrupt income in such a short time (two years) from a procurement position that involved mostly fairly small contracts. Additionally, this weakness could in some way be linked to the form of public

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94 Dagens Næringsliv, March 13, 2010 summarizes the case.
95 One motivation for introducing more private sector-like institutions into public governance has been to increase mobility between the private and the public sectors. This was expected, for example, to make it less attractive to stay in a given public sector career ladder, or to make it easier to move from a private firm to a public enterprise. To increase this mobility the salaries in senior public sector positions had to increase. When the official started to be afraid of discovery, he moved back to his former private employer.
96 In these, one bidder receives priority for a number of smaller projects similar in nature so that the procurer would not have to organize a number of different tenders for procuring essentially the same services. It saves on transaction costs, but may be more exposed to corruption risks than some of the other forms.
97 VG, September 28, 2006.
organization chosen (such as the increased powers allocated to heads of sub-units in most NPM type of organizations; see Andvig, 2001), that make it easier for them to engage in corrupt deals. This general effect was compounded by the fact that the organization M. was heading was new, hence had not developed monitoring routines. The nature of M’s position, as well as the characteristics of the construction industry itself – the many small and difficult to monitor repair works spread over a large number of buildings in an industry where suppliers need a surplus of contracts in order to keep a constant income stream – made the suppliers willing accomplices to the high frequency of corrupt deals in this case. The centralization of a large number of fairly small contracts (but contracts large enough to pass the bidding thresholds) made formal bidding rules difficult to follow even if the procurement officer was not seeking corrupt income. In such circumstance non-compliance would not automatically be considered highly suspicious by the fellow officers, but rather as a pragmatic adjustment to a work setting where strict rule obedience may cause considerable delays and gridlock. It is striking that most of the corruption scandals that have reached public attention in Norway have focused on officials in M.’s position.

The other case was in fact taking place in the same institution, again probably reflecting an exceptionally weak monitoring at Undervisningsbygg. The formal procurement rules in the institution were up to standards but they were not implemented. In the second case the actions apparently also were initiated by a public employee – a project leader – who had a fairly autonomous position. He diverted only about the tenth of what M. had received but in this case, most of the income was earned through one single company that practically worked only for Undervisningsbygg. The company quickly grew once the contact was established. Although, this case represents a local pocket of corrupt influence on Undervisningsbygg’s procurement, the fact that this official was doing his own private property consultancy business while sharing ownership interests with the company favored in his procurement decisions is of greater policy interest. And even more intriguing, this official and M. were recommended to Undervisningsbygg by the same headhunting firm.

Another property manager, H., employed at Ullevål University Hospital was caught in a somewhat similar case in terms of the scope of corruption and the final punishment received (a jail sentence of about two years for the main actor). Yet, this case involved heavier economic forces. By the time (2003) when H. was employed at the property division of Ullevål University Hospital, the division and the hospital itself had been reorganized around the NPM ideas. However, it was known that another member of the hospital’s staff had been involved in dubious procurement decisions since 1990. In such an environment, H. evidently

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98 It may then be misleading to assume that the public employee was the active agent in this case. He may simply have been hired by the company.

99 Moreover, twenty years earlier he had been caught as second in command in a large liquor smuggling organization, a fact apparently not noted by the headhunting company. See Gedde-Dahl and Kagge (2006) that summarizes the case at the same time as it reports on the information collection methods used by them when researching it.

100 The following outline of the case is mainly based on Gedde-Dahl et al (2004) and Oslo Tingrett (2006).
felt secure and almost immediately began to revise existing contracts to the advantage of firms known to him. What was remarkable was H.’s journey before being employed at Ullevål University Hospital – employed for four years in the Norwegian division of an international construction company with Swedish headquarters, PEAB, where he got to know its Norwegian division management and a number of subcontractors. He then moved to the property division of the Norwegian State Railways (NSB) as a development manager. He was later promoted as the deputy head of ROM, a more commercially oriented descendent of the NSB. During the first period, he was allowed to work for PEAB at the same time as he was handling PEAB-NSB relations in connection to two contracts of about NKR 100 million each. Since PEAB had a number of development interests in the Oslo region, while NSB owned very valuable land in the city, this was a very risky alliance from a governance perspective. During this period, H. received considerable economic rewards from PEAB. In the end, H. had to leave NSB secretly and in disgrace. He then got his job as a property manager in the Ullevål University Hospital where he managed to bring with him some of his old business partners, including PEAB that paid for a teambuilding hunting trip to Sweden for H. and his new colleagues. While not of significant interest to PEAB, H., or some of his old contacts, could still be of local interest to the company.

PEAB was not convicted of corruption in either case but accepted a corporate fine. Hence, while it avoided a general debarment from public activity in Norway (or in the EEA area as a corruption verdict should imply – S. Williams, 2006), Ullevål University Hospital decided to shun it for a number of years. The smaller private entrepreneurs also received jail sentences.

PEAB was also the main supplier in what has become the most widely published corruption case in Norway, the so-called “waterworks” scandal. Like M. in the Undervisningsbygg case, the main individual involved, ITH, succeeded in becoming rich at least partly through a misuse of his position. ITH was a CEO in two enterprises – a waterworks and a water cleaning enterprise – both co-owned by several municipalities in the same region. This corporate form allowed its CEO exceptional freedom of action. During his long tenure, ITH developed a large, mostly local network through which to transfer money into his and his family’s accounts using a system of overbilling. When his own private enterprises received sub-contracts from the main contractors of supplies to the municipal enterprise they overbilled, as did the main contractors. To some extent, this was related to the fact that competitive bidding was rarely, if ever, used. The latter was easy to avoid, since these enterprises fell under the category of ‘public works’ where the legal limits for prescribed competitive bidding are higher. PEAB became the in-house supplier delivering around NKR 100 million in a ten year period without partici-

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101 One enterprise had to be liquidated when its contract with the property division was cancelled. The head of that enterprise in the end told the story to a leading newspaper.

102 The Norwegian branch has around 3 billion NKR in annual turnover of which 10-15% is supply to public institutions (Aftenposten, February 14, 2008). Otherwise most of the following is based on Gedde-Dahl et al (2005). ITH received an eight years jail sentence in 2008.
pating in any competitive bidding. The main auditor was employed by the PricewaterhouseCoopers – the company that is most pronounced in fighting company corruption in Norway. PricewaterhouseCoopers and PEAB have both accepted to pay the municipal companies compensation but have successfully fought fines for being involved in corruption.

Although large companies are involved, it is not clear whether these local developments are the result of aggressive supplier behavior (the perceived excess supply argument), stimulated by management policies (but where the executives have protected themselves from concrete knowledge), or are due to the development of more random local pockets of cross-enterprise-politician network supported by slack monitoring at both ends. Most of the evidence so far is pointing to the local pocket interpretation but since ITH knew the former head of PEAB Norway and a middleman between PEAB and ITH has been involved and claimed compensation, the case is open for a different interpretation. Further research into it could very well show it to be indicative of how project-based organization stimulates the need for stable cross-organizational networks.

Being among the larger corruption cases recently registered in Norway does not wholly explain why it received considerably more public attention than other similar cases. Some exotic features could have contributed to this – journalists discovered that part of ITH’s profits was invested in a large game farm in South Africa where he entertained a number of his business associates. Compared to this game farm, M.’s fishing trips to Mauritius appeared less extravagant.

While the above cases may be seen as resulting from a lack of monitoring at either the purchasing or both the selling and purchasing end of the bribery ‘market’, they are also due to the deliberate sales policies of large companies.

As in some of the other cases described below, Norwegian courts appeared unwilling to sentence major private enterprises on corruption charges. Whether this is due to respect for their reputation, considerations for the potential negative effects of the sentence on the large number of potential jobs after the new corruption legislation, or the difficulties involved in determining proof in these cases, is difficult to tell. They suggest, however, that the strong potential effects of any sentencing expected by the application of the EU debarment policies could, on such occasions, very well backfire and lead to counterintuitive acquittals.

2.4.2. Risks in Defense IT Procurement

The Norwegian defense sector could be described as procurement intensive. While the share of defense in total public expenditures was about 3.9% in 2008, its share of public procurement was 6.6%, or about NKR 25 billion. Several of the largest corruption scandals in Norway have also taken place in this sector. This is not surprising since much of the
equipment and systems or services procured by the defense are complex and cannot be sold at open markets with public quality standards and listed prices. Moreover, for national security reasons, transparency cannot be fully demanded and could thus be used as a cover for illegal gains.

The largest publicly known case so far involved the Norwegian Ministry of Defense and the German engineering enterprise Siemens. At the heart of the bribery transactions were 2,700 business consultancy agreements. Siemens has been involved in a number of bribery controversies worldwide and has introduced – among other measures – a set of internal controls over its own bribe payments so that its employees would not receive a share of the bribes. This entailed a large monitoring apparatus due to the size of the company – almost half a million employees in 190 countries.

Causing discontent in Germany in November 2006, and mounting evidence elsewhere, finally forced Siemens to plead guilty in 2008 for having made improper payments on a large scale. The company accepted to pay the US authorities the largest settlement payment thus far recorded ($800 million) for violating the Foreign Corrupt Practices Act (FCPA); a similar amount was also paid to the German authorities. In Norway, Siemens was quite large with a substantial number of employees (4,000). This fact likely influenced the way in which Norwegian authorities responded when the company got involved in corruption scandals on Norwegian soil, the largest one connected to the Norwegian military.

Yet, the events described above do not imply that each part of a large engineering concern, such as Siemens, operates in the same way. Instead, a corporation is partitioned into profit units and groups that in most respects behave independently of the mother company. Such units conclude contracts with other enterprises and public authorities in their own ways, each letting their employees engage in various task networks or projects in the manner outlined in section 1.2 above. Variations of bribing strategies across multinational concerns reflect variations of evolving informal codes. More specifically, these are variations in sales and profit rates pressures, rather than explicitly formulated bribe instruments guiding most profit groups and influencing the propensity of internal enterprises to engage in corrupt transactions.

One such Siemens group in Norway was Siemens Business Services (SBS) AS, associated with the international SBS company that was a part of the Siemens conglomerate. The Norwegian division had about 400 employees, consisted of four departments and was working at the time on a large IT contract for Norwegian Defense (the FISBasis contract) which was at the core of this case. The contract was for equipment delivery and IT solutions for integrating the army, air force, and marine systems into one (Oslo Tingrett, 2005). The size of goods and services delivered by the contract

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104 Incidentally, Statoil has received the 7th largest fine ($20 million) on a list of top 10 FCPA settlements (see Wong and Conray, 2009: 5) for its bribing of Iranian authorities, but this is outside of our purview of research since the oil companies bribery incentives are quite different with regard to domestic procurement and foreign licenses to explore and extract.
were close to NKR 1.5 billion. Formally, the competition for the FISBasis contract was organized in three stages: 1) an open prequalification process for potential Norwegian-based contracts, where 39 enterprises participated (autumn 1999) and 6 cleared this hurdle; 2) a competition with announced negotiation; 3) two suppliers were found worthy to participate in the final negotiations, SBS and Telenor Bedrift. Negotiations ended in 2000, and SBS won the contract in January 2001.

The scandal broke through a whistleblower, PYM, who was employed as the economic controller of one of the divisions of SBS. PYM reported to Siemens headquarters that SBS systematically overbilled the Defense authorities. The headquarters informed the SBS Norwegian management of the whistleblower’s actions and PYM was fired. Meanwhile, no measures were taken to prevent overbilling. Since, according to Norwegian law, there were no legal reasons for the dismissal of PYM he won a court case against Siemens (Oslo Tingrett 2005). In the meantime, the case was brought into the limelight by the media. Public attention was reinforced by the fact that PYM was the brother of a very popular TV star making documentary wildlife movies. In addition, many of the persons involved in the case engaged in lavish activities (hunting, overseas golf trips) with representatives of Siemens and its associated consultancies and defense officials, all paid either by Siemens or the consultants (although the Norwegian economic police – Økokrim – was unable to prove that any of the overbilling was spent on bribes). The entertainment of defense officials was not sufficient to get anyone convicted for corruption during the court hearings that took place in 2008 – 2009. Siemens paid back the overbilled amount estimated at around NKR 40 million.

Not only did the case of the FISBasis contract shed light on the governance issues of hard selling by multinational companies in competitive public tendering processes but also showed how the modernization and downsizing of a government bureaucracy could expose it to corruption risks by creating a patchwork of different organizations or work units (such as the ones involved in the FISBasis case both before and after the tender). At the time of tendering, organizations that were strictly “internal” (i.e. under the command of the procurer – the Defense Logistical Organization [Norwegian acronym FLO]) themselves consisted of 50 organizational units (Dalseide et al, 2006: 40) of over 1,400 employees. There were also semi-internal units, such as individual consultants and firms, hired and paid by FLO. On the Siemens side, there were four divisions, not all equally engaged, which constituted the “external” organization – the supplier. As the supplier, Siemens hired a number of consultants, which constituted the semi-external part of the FISBasis project.

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105 This procedure followed the Ministry of Defense procurement rules at the time.
106 In addition to a number of newspaper articles the main sources of the following discussion is the Dalseide commission (Dalseide et al., 2006) and KOFA (2007).
107 The FISBasis contract included the delivery of more than 17,000 computers. Their purchasing price, following market conditions, declined rapidly. If sold at the old prices – a major feature of the overbilling procedure – the SBS commission would increase well above the 8% rate agreed in the contract.
The downsizing of the defense administration played an important role in the above situation. Almost half of the staff in the economic department of the Ministry of Defense was released, many receiving early retirement settlements. Since the complexities of downsizing are often underestimated, a number of tasks had to be performed by former employees acting as external consultants who could de facto earn two incomes – their pensions and the consultancy fees. Moreover, they had strong connections to the FLO and were in the age group where corruption risks are high. New subunits were created rapidly at the government level, while individuals moved in and out of consultancy firms or created new ones. An important goal for FIS Basis, and even more so for its successor programs GOLF and then LOS, was to bring some kind of order into this situation.

While in the end no one was sentenced for corruption, at the core of the case was the following scheme. An “independent” private consultant, BR, was heading a project of reorganizing the Norwegian defense authorities and deputy head of the tendering process at the same time as he was a consultant for one of the main bidders for supplying new IT solutions for the reorganization – the competitor that won the major contract in the tender. He was involved in the lavish entertainment of the defense officials which contributed to the exposure of the Siemens case. More importantly, BR had once been an army captain and employed by Siemens. He (and/or his consultancy firm) was hired in the preparation of the FISBasis tender as early as 1997. After the bid was awarded to Siemens, BR was hired as a consultant in the process for both FLO and Siemens. As such, BR received about NKR 60 million from each and about NKR 40 million as a subcontractor for another consultancy firm (Dalseide, 2006: 144). BR also contributed to the reorganization of the Ministry of Defense by working on the preparation for the next stage – GOLF, a project implementing a number of economic steering mechanisms to the IT platform created by the FISBasis project solution.

FLO published a tender notice for consultancy services on November 17, 2005, but waited for the Dalseide commission report, and then refused to participate in a bid led by BR. BR complained, but his complaint was not accepted by KOFA (the Complaints Commission for Public Procurement), and his prejudgment status was thoroughly analyzed by it. But in 2008, BR was once again accepted as a potential provider of consultancy services to FLO, indicating how skin-deep the understanding of the importance of loyalty has become in the fragmented forms endemic in the relations of the modern Norwegian administration with the private sector.

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108 Experience from the North Sea oil industry cases indicated that older professionals were more involved in semi-legal and illegal information brokering. A number of overlapping generational models of corruption provide some theoretical arguments for why the older generation tends to engage more frequently in corrupt transactions, e.g. Lui (1986).

109 The main initial contract for GOLF was given to IBM despite BR's Siemens affiliation. The story of GOLF and the later LOS has not yet been elucidated in public, and it is not clear if it ever will.

110 It was written by Professor Kai Krüger, a leading Norwegian law expert on public procurement.
The two public procurement cases described here are among the most difficult to govern: the procurement of construction services and the procurement of IT systems. In these, the increased corruption risks appeared to be related – to a certain extent – to the institutional changes associated with New Public Management.

In the case of procurement of local building services, institutional reforms have been somewhat superficial. The procurement agency adopted the characteristics of a typical private enterprise which seems to have increased the corruption risks. Still, this has always been a risky sector due to a number of factors: heterogeneous objects, value of properties influenced by regulation, large costs involved, and/or a long stream of procurement decisions to be made. Often the rules of tender procedures have not been followed not because of ignorance, sloppiness, or rent seeking but simply due to an excess of procurement decisions. While more frequent in agencies which simulate private companies, this kind of corruption has also been observed in more traditional Norwegian municipal bureaucracies. The experiences outlined here indicate that this type of corruption could be expected to be higher in cases where easier cross-sectoral mobility is combined with adverse selection mechanisms.\(^{111}\)

The same applies to the procurement of IT solutions, although for the different reasons. Here the procurement agency itself is likely to undergo structural changes. Since there is little capability for monitoring, and given the substantial changes, the agents involved know that the organization that started the tender is not the same as the one that will evaluate the outcome. Moreover, the choice of an IT solution is part and parcel of the transformation which is intended to freeze the new public management principles into new institutional structures. It is therefore more intimately connected to the NPM culture that dominates Norwegian public management thinking today. During its implementation in the Defense’s Logistical Organization through the FISBasis and GOLF/LOS projects, the organizational and accounting complexities encountered were so difficult to control or monitor that it could hardly be done before the new system was in place. In this environment of missing control several serious governance issues arose. While corruption is likely to have been one of them, the lack of transparency in the process itself makes that proposition extremely difficult to verify, as indicated by the withdrawal of most corruption charges by the economic police.\(^{112}\)

2.5. Public Procurement and the Nordic Price Cartels

Cartel collusion is another governance issue frequently associated with public procurement. In fact, court cases involving illegal cartels have entailed much larger enterprise fines and larger economic values have been involved in those than in the Norwegian corruption cases. At one level it represents collusion among suppliers against a procurer (and the

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111 A case in point which took place in the property division of the municipality of Bærum is described in Renå (2009).

112 The dismissal by the court of most of the remaining charges made by Økokrim may have come as a consequence of the defense policy debate at the time that made it reasonable to suspect that the corruption charges may have been initiated by the government in order to weaken some of the political opposition to its policies.
public) to gain access to and share the rent from a given public expenditure, while a bribe represents a collusion between a supplier and a procurer (or one of the procurer’s agents) against the other suppliers (or the procurer) and the public.

The time scale of bribe transactions and cartelization differs. While it makes sense to bribe a procurer in a single, isolated tender, to organize a cartel for such an event is meaningless – only one competitor will win. Yet, in a sequence of bids, organizing a cartel makes sense. Moreover, cartels are easier to set up when sales mainly occur through public tendering, compared to private sector sales. During these biddings, information useful for mutual monitoring of eventual agreements is produced. A key problem when organizing cartels is their instability. Given the fact that eventual cartels will have to develop over time and over a number of bids, cartel agreements may be wholly informal without any explicit written or even oral coordination. Instead, a shared understanding may be sufficient. The legal difficulties involved when trying to prosecute companies that have reached such understandings are obvious. High bidding costs, including the need for highly qualified personnel for bid formulation, may obstruct the entry into public procurement tenders, while encouraging cartel organizations.

The value of getting into a cartel increases with the number of public procurement bids that any given cartel members can join. This implies that the prospects of collusion – especially cross-border – are likely to increase when the number of public procurement tenders increases, as they will do when the same set of enterprises participate in contests organized by public organizations in a larger number of countries. This tendency is observed in the Nordic countries.

The reason why collusion is relevant to a discussion of corruption in procurement is that cartels could be expected – at least if strongly disciplined – to be an alternative to corruption: why should enterprises that have a de facto monopoly of supply be willing to pay any bribe to a public official? This argument presupposes that the procurement decision is already made and there are no potential competitors. While the possibility for developing international cartels increases, the prospect that they may become all-embracing diminishes.

In fact, experience shows that – counter-intuitively – corruption and cartel organizations go together. One possible reason may be that if the motives for unexplained economic gains increase and the respect for rules decreases, an increased propensity for cartel creation and corruption is likely to appear. If so, this should be mainly reflected in economic time series, although the analysis here is of a cross-section issue. There is possibility that, like the information brokers found in the oil industry, a procurer could become the organizer of a cartel. If he/she does, the overall rent to be shared could increase, while the likelihood of exposure decreases since no competent organization now has any motive to blow

113 A considerable amount of research based in game theory has been done in order to determine when such informal cartels in fact had been established or not. An early, crisp textbook presentation is Basu (1993: 149 – 162).
the whistle. From a public governance point of view, this is an exceptionally serious case where regular public authority has broken down.

In some cases the same action – for example, paying the management of a smaller company not to bid – could be regarded either as bribe or as instrument in cartel-making. The payment may be completed through invoices for fictitious services, much like the cases of corruption in Oslo’s building industry. A number of real world scenarios could exist and they could be rather complex:

- Smaller companies wanting to break a monopoly could bribe employees of the “insider” companies to expose schemes to the authorities.

- Employees could whistleblow because they are about to be fired or for some other reasons harming the company’s authority structure.

- Employees could be selling information to a competitor to enable the latter to police the cartel agreement, etc.

The existence of a number of such variations implies that it is too simple to assume that governance failures are sort of cumulative – one problem only exacerbates another – and, conversely, governance advances are always unqualified. Adopting such assumption is tempting in policy making because it allows politicians to propose clear-cut solutions where none exist. Policy-making truly concerned with actual impact needs to outline trade-offs and make assumptions about the strength of the various factors.

Such a simplistic association between cartelization and corruption as governance faults is evident in a research report from the Swedish Competition Authority in which they “are considered as two sides of the same coin” (Konkurrensverket, 2009a: 8). It is argued that collusion and corruption should be studied together – a reasonable proposition when it comes to public procurement organized through public tenders and auctions. Yet, as argued above, one reason why they should be studied together is the tradeoff between cartel and corruption propensities in bidding processes, not any strict positive correlation. With a lot of public information contained in the bids, corruption becomes more difficult, while the enterprises’ cartel monitoring is eased. Through a more stringent demand for exact formulations best price auctions become feasible in more complex situations. This again increases the complexity of arranging corrupt deals, but makes it easier for cartels to survive by increasing the entry costs to the competition.

The largest known case of collusion in procurement tendering is from a Swedish court where the enterprises involved – which had been able to sustain a disciplined cartel for at least a decade – were fined 450 million Swedish kronor (about €50 million; Konkurrensverket, 2009b). The case was brought into public limelight in 2001 by a couple of whistleblowers in one of the companies with the final verdict announced reached in 2009. The enterprises had been engaged in a large number of public bids for asphalt coating for different local and state authorities. Some of these
enterprises had been accused for the same cartel practices in Norway
(overpricing, paying potential bidders for not participating, and so on);
some of them have sustained minor fines, yet no final court case cur-
rently exists, although it has been estimated that up to 2003 the public
authorities had lost about NKR 400 million in cartel-based over-pricing
by these companies.114

While the larger companies have so far avoided sizable fines, local firms
have received considerably heavier fines for local cartel making. A local
municipality in Mid-Norway organized a tender for rehabilitating some
local bridges. The winning bid was at about NKR 10 million, while the
actual costs of the work were later estimated at about 4.3 million. The
two companies involved were recently fined NKR 7 million.115

In 2002, the public supply of road goods and services in Norway went
through a major reorganization where the sections involved in road con-
struction and maintenance were separated out. Although still state-owned,
they were now instructed to behave like private enterprises and bid in
tenders arranged by former colleagues. The idea was that the ensuing price
competition would result in lower construction and maintenance costs.
Yet, this was only true in the first few years.116 In general, a certain block
of roads in a geographical area was designated, and qualified enterprises
were asked to bid for the maintenance of that block of roads for a five-
year period. At the time, only best price tenders were announced, but
the demands for detailed specification (and therefore also bid costs) have
increased. In 2008 and 2009, the prices increased steeply and the govern-
ment costs for road maintenance moved back to pre-outsourcing levels or
above. These events, together with a few widely published quality failures,
initiated inquiries into the bidding system for road maintenance contracts.
An evaluation report commissioned by the Ministry of Transport (Dovre
Group AS, 2010: 33) mentioned the possibility of cartel behavior (although
it had not been commissioned to explore that possibility) among the rea-
sons for the price increases. In most tenders, there were fewer than two
participating enterprises. This experience illustrates the possibility for cartel
making in situations where a former public organization becomes either
wholly privatized or forced to operate under market-like conditions. This
model once applied to most of the Bulgarian economy, but significant parts
of the public sector in Norway have shared that experience too.

While the estimated fines and economic harms may be equal or larger
when comparing the effects of cartels to corruption in a Norwegian
policy context, the ethical concerns are undoubtedly stronger in the lat-
ter case. The reason may be partly historical. As Basu (1993: 150) noted
in his textbook on industrial organization, cartels in Europe (as in Korea
and Japan) have been mostly legal during a long historical period. The
strict anti-cartel laws introduced in the EU are recent and inspired by

114 Some of the involved enterprises have also been sentenced by a Finnish court to pay more
than €82 million (Supreme Administrative Court, Messages, September 29, 2009).
116 Arnesen and Hagen (2008) used the falling costs as a verification of the increased efficiency
that has accompanied caused by the outsourcing of public services to enterprises engaged in
bid competition.
US laws. In fact, the post World War II price and microeconomic policy was based upon a deliberate cooperation between private enterprises and public authorities, which would be facilitated if private enterprises cooperated in cartels.117

Ethical norms that evolve in group behavior may have been even more significant. A strong belief in the membership of a formal organization seems to characterize the Scandinavian scene. Even when cartels shifted from being a cooperative venture between private enterprises to a game where some enterprises play against the authorities (and some other enterprises), the agents organizing the cartels do it to further the (perceived) interests of the enterprise that employs them. To engage in corruption, however, is an act of *disloyalty* against at least one group (in most cases a public organization).118

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Since systematic empirical research on governance issues in public procurement is not available for Norway, this section has relied on court records or fairly concrete and factually researched media stories. While these provide a good basis for illustrating the mechanisms at work, they are, of course, insufficient for a more accurate estimate of the extent and significance of corruption and cartelization in public procurement in Norway.119

2.6. Corruption in Public Procurement in Bulgaria

The Norwegian experience with the impact of corruption and cartelization on public procurement could serve as a rough guide for studying these mechanisms in Bulgaria as well. In turn, some data from Bulgaria may shed additional light on the Norwegian experiences.

In both countries – as in most other EEA countries – a centralization of public procurement functions in important sectors has taken place. In an analysis of the centralization in the Norwegian public health sector procurement Fehr (2007) points to the increased emphasis on the need for economic and legal expertise that goes with more rigorous bidding systems and the increased power of the economic management in public hospitals. Fehr does not discuss corruption in this context, but an important observation by the Center for the Study of Democracy (2009: 82) is that corruption in Bulgaria, particularly with respect to public procurement, has become more centralized. Was this driven mainly by internal political developments or was it the result of harmonization with EU law? Perhaps Norwegian developments can provide a clue.

There is a lot to be learned by comparing Bulgaria to Norway partly due to the expected higher prevalence of corruption in Bulgaria, which may make it easier to validate potential patterns from the general data, par-

117 A good explanation of this policy may be found in Chapter 12 in Aukrust (1965).
118 The same kind of commitment to a member organization may increase the social costs of whistleblowing too, if that harms one’s organization.
119 For an attempt to assess the extent of corruption in the Norwegian oil industry in the early 1990s see Andvig (1995).
An t i-C o r r u p t i o n in p u b l i C p r o Cu r e m e n t: bAlAnCi n g t h e p o l i Ci e s

particularly as more empirical research on corruption is available in Bulgaria. It is arguably the best covered country in the EU in terms of empirical research on corruption issues. Somewhat unexpectedly, Bulgaria’s public procurement statistics are more amenable to economic analysis. Conversely, statistics on public procurement in Norway are surprisingly spotty and difficult to handle for macro-oriented analyses.

According to the most recent Corruption Perception Index (CPI) of Transparency International (TI) (Transparency International, 2010), corruption in general should be more extensive in Bulgaria than in Norway – while the latter is ranked as 10th, Bulgaria is 73rd out of 180 countries (a position higher in the list is considered to signify less perceived corruption). When it comes to daily experiences with corruption, the differences remain striking: while only 2 out of 1,000 report this kind of experience in Norway, 84 out of 1,000 report daily experiences with corruption in Bulgaria (van Dijk et al, 2007: 90 – 91). It is also interesting to note that the perception of the main culprits appears to differ widely. According to the 2009 CPI (Transparency International 2009a: 30), the judiciary was considered to be the most corrupt public sector by 38% of the Bulgarian respondents, while the business/private sector was considered relatively clean. In Norway, the situation was the opposite: here only 3% of the respondents considered the judiciary as being the most corrupt, while 62% believed that the business/private sector was corrupt. While these differences in beliefs may not necessarily correspond to reality, the high guilt factor associated with businesses is likely related to Norway’s large oil sector with its accompanying construction activities.

Large as the differences in the daily life and perceived corruption may be between Norway and Bulgaria, they are likely to be smaller with respect to public procurement since the latter is a high corruption risk area in rich and poor countries alike. Moreover, public procurement involves the interaction between mainly private businesses – the perceived high risk sector in Norway – and public institutions. Note that surveys based on businesses’ perceptions about corruption in Norway indicate much higher incidence of corruption than surveys based on citizens’ opinion. In a survey by the PricewaterhouseCoopers (2009a), 21% of the business respondents report corruption incidents in Norway (the global average in which Bulgaria is included was 27% [PricewaterhouseCoopers, 2009b]).

One of the most comprehensive studies of these issues in Bulgaria was carried out in 2006 by the Center for the Study of Democracy in its report Corruption in Public Procurement: Risks and Reform Policies. The study begins after the major transformation of the Bulgarian society from a centrally-planned to a market economy had already taken place, and a large chunk of physical capital assets had been privatized. Hence, corruption during public sales of assets (with their eventual competitive

120 Both data sets are imprecise, but they serve the purpose of this paper.
121 It is also likely to be the main reason why Norway ranks as more corrupt than the other Nordic countries on the corruption perception indicators of Transparency International and the World Bank Institute.
bidding symmetrical to procurement bids\textsuperscript{123} has not been the focus. The study uses various registered characteristics of the bidding processes applied to Bulgarian public procurement as signals for underlying corrupt transactions.\textsuperscript{124} These are, naturally, used as proxies (with all the concomitant ‘noise’ that they could carry) but could form the core of a monitoring system of corruption in public procurement.

Such monitoring is currently carried out by the European Commission which, however, is confined to generalizations or relies mostly on law enforcement indicators:

“Shortcomings in the implementation of public procurement procedures are widespread... Bulgaria initiated checks by its competent authorities which have established an irregularity rate of 60% among all tenders verified. This rate reaches almost 100% for large public infrastructure projects where the authorities have an obligation of ex-ante control.”\textsuperscript{125}

Assessments such as these need to be combined with the methodology applied by the Corruption Monitoring System of the Center for the Study of Democracy in order to provide reliable data informing better fine-tuned policies targeting corruption in public procurement (this point is further developed in section 1.1.4 above).

According to Pashev (2010: 18), public procurement constitutes about 10% of Bulgaria’s GDP. About 50% of public procurement is composed of construction, 30% of goods, and 15% of services. When compared to Norway, the most striking differences are the much lower share of services (which in Norway was about 40% of public procurement)\textsuperscript{126} and the much higher share of construction\textsuperscript{127} (less than 20% in Norway). Corruption risks, as well as the forms of bidding, differ across the different components of procurement but risks are likely to be largest in large scale construction. The difference in composition is surprisingly large, but may be due to a different choice of classification systems. That public procurement constitutes a larger share of GDP in Norway (about 15%) is to be expected, as Norway has a higher income level; additional factors accounting for the difference could be the higher level of public spending and the existing oil industry in Norway, and the currency board in Bulgaria which has a limiting effect on public spending, the smaller value of investments and the large private sector in Bulgarian economy (which is therefore not obliged to use the tools of public procurement).

\textsuperscript{123} Pure highest price bid in this historical situation should lead the most valuable assets into either the hands of foreign capital owners or people who had operated in the black or grey markets in Bulgaria. Presumably, the actual distribution of political pull forces combined with the existing distribution of cash and technical knowledge determined the outcome. While hardly ideal, clean-cut competitive bidding might easily have generated worse results.

\textsuperscript{124} Unfortunately, any similar systematic registration of bidding characteristics among the Norwegian procurement data is not available. This makes it difficult to compare corruption levels in public procurement processes between Norway and Bulgaria.

\textsuperscript{125} European Commission, 2011a: 3,6.

\textsuperscript{126} DIFI, 2009.

\textsuperscript{127} Due mostly to large scale infrastructure projects in Bulgaria over the last 15 years as part of general reconstruction of the country supported by IMF-World Bank, EBRD, EU pre-accession funds etc.
According to their own reports, the share of enterprises that admit to have paid a bribe when engaged in a public procurement contract in Bulgaria has been rapidly declining with Bulgaria’s EU accession.\textsuperscript{128} While about 50\% of the enterprises admitted this kind of behavior in 2002, only 10\% did so in 2007. The enterprises’ behavior followed the citizens’ trend towards lower engagement in street level corruption, as recorded in a number of surveys by Vitosha Research.

After 2004, a divergence between business and citizen behavior has been recorded, however. An upsurge in corruption among citizens took place after 2004, while business corruption continued its decline.\textsuperscript{129} Part of this decline can be explained by the lower fraction of enterprises that participated in public procurement and, therefore, had no direct experience with eventual corruption in public procurement. Yet, an unexplained phenomenon remains.\textsuperscript{130} The size of the paid bribes, as a share of the procurement, appears to have increased. Several hypothesis accounting for this could be put forward:

- The transposition of EU Directives after 2006 has made procurement more restrictive, complicated and therefore expensive to business. This entails a reduction in willingness to participate, especially among SMEs, while at the same time not limiting big companies to use high quality consultants’ services.

The shrinking in the number of public procurement bidders down to 10\% of companies is due in part to some positive factors, such as the expansion of market opportunities beyond the public sector, but it could also be attributed to the trend for many companies to forego participation in bidding procedures, as they are convinced these are restricted by administrative means to a few pre-selected bidders. The high concentration of the public procurement market both on the contracting authorities’ and the contractors’ side promotes the establishment of lasting bribery schemes and corrupt relations (Center for the Study of Democracy, 2009: 82).

- Corruption centralization as a trend (as described above) discouraging all but traditional big players;

\textsuperscript{128} See Center for the Study of Democracy, 2006.

\textsuperscript{129} Center for the Study of Democracy, 2009: 21 – 22.

\textsuperscript{130} When asked about their attitudes about what other enterprises are doing, the belief that corruption in public procurement is widespread remains unchanged and is shared by about 60\% of the enterprise respondents.
• Recession restricting financial capacity of many companies and their access to bank loans, and others.

A host of other factors also contribute to a changing situation in this field:

• The fact that larger enterprises have started to dominate the various public procurement markets decreases the number of enterprises involved while enabling the substitution of illegal influences on authorities by means of bribes, with the more legal, but still often secret, means of lobbying or silent political pull.

• Related to this may be the generally friendlier attitudes of the authorities toward business. If so, bribes may no longer be necessary to wield influence by enterprises, but may remain so for citizens.

• The underlying features inducing bribes as instruments of influence may remain unchanged, but a desire to become member of the EU may have had a temporary mitigating effect on both sides of the procurement markets. If so, procurement-related corruption could be expected to increase again.

• The situation may remain unchanged, on the other hand, but the new EU-driven procurement regime makes it more risky to admit having paid a bribe (because of the debarment rule), or some decline may have taken place. This decline, however, itself makes it more risky to admit own experience, so the reported decline exaggerates the actual decline.

• Related to the above is the possibility that the new, more rule-oriented regime actually works, so corruption in procurement actually decreases due to a successful procurement policy.

It is clear that, to be able to distinguish between these possibilities, one would need an unrealistic amount of empirical data. Still, their absence at present makes the application of a monitoring system all the more pressing. CSD’s 2006 study uses the frequency of violated procedures as an indicator for corruption incidence. In general, the study finds (for the years 2003 – 2005) about 1/3 of the procurement procedures embracing about 50% of the value of the contracts to have been violated. Seemingly, this is a very high fraction of violations, and the Norwegian fraction could be expected – based on anecdotal evidence – to be much lower.\textsuperscript{131} If violations of procurement contracts are a reliable signal for corruption incidence, this could question whether the difference in corruption incidence between Norway and Bulgaria is as large as commonly believed. Of course, as with any proxy for corruption, it needs to

\textsuperscript{131} The Norwegian newspaper \textit{Aftenposten} once (May 15, 2008) made an auditing of 122 procurements of consultancy services at the office of the widely respected Minister of Foreign Affairs, Jonas Gahr Støre and found that in more than 50% of the cases there had been a violation of procedures. The most serious violation was that several of them applied to the consultancy firm ECON where Støre formerly had been a partner. In another case the auditing office of Oslo municipality made an auditing sample of 35 procurements (Oslo kommune, \textit{kommune revisjonen}, 2005). It discovered 13 violations – close to the Bulgarian average.
be used advisedly since, depending on the circumstances, it could also indicate well implemented oversight.

Another indicator of corruption in public procurement that could be used is the fraction of bidding auctions that either applies negotiations or some form of restricted procedures, compared to the share of procurement acquired through open competitive bidding with publicly pre-announced winning criteria. Roughly, about 3/4 of the procurement used open procedures without negotiations and 1/4 applied bidding with negotiation over the period 2000 – 2006. Restricted procedures were quite common in the first two years (around 10%), but used only sparingly in the last two years (about 1%). Again, it is logical for the choice of bidding procedure to be used as a signal for corruption risks, as bids allowing post bid opening negotiations are likely to be large, complex, and costly projects, where both the incentives for large economic gains are strong and the likelihood of discovery is small. Yet, this signal needs to be cleared of noise about the incidence of corruption among public officials, since more often than not there are valid transactional reasons for the choice of bidding procedure.

With some degree of approximation it could be said that what the oil industry is for Norway, procurement in the energy sector is for Bulgaria. Energy enterprises hold roughly one-third of the top ten positions of the biggest awarded contracts. Over the past two years they have awarded contracts worth more than €850 million, or approximately 10% of all awarded contracts over the period and even that is only a fraction of the value of actual contracts. The high concentration of public funds in this particular instrument generates a persistent risk of corruption, fraud and abuse of public financial resources.

Most of these conclusions are based on research by the Center for the Study of Democracy. The absence of comparable data at the micro level, however, for Norway and Bulgaria underscores a key challenge for the European policies in this area. If, for example, the distribution between goods, services, and construction is as different between Norway and Bulgaria as indicated above, a much higher fraction of negotiated procedures in Bulgarian public procurement should be expected. Without such data – which could be generated by a system of monitoring as outlined in 1.1.4 above – it would be impossible to evaluate the impact on corruption of EU’s policy of encouraging cross border bidding for government contracts.

132 Center for the Study of Democracy, 2011a: 64.
2.7. Modeling the Effects of Cross Border Competition in Procurement Bidding on Corruption Propensities

As noted in the previous section, Bulgaria and Norway are at the opposing endpoints on the scale of corruption within the EEA, which embraces countries ranging from low to medium corruption propensities. According to a number of international assessments – such as the World Bank Institute’s perception indicators, the TI Global Barometer or the International Crime Victimization Surveys – there is a significant variation in the corruption rates among the countries in the EU-EEA area that have agreed to apply the same rules in their public procurement, including equal access for suppliers in the area. While each indicator is rather unreliable, at least they provide a clue to the likely variation – e.g. according to TI’s 2010 corruption barometer the reported experience with petty corruption of citizens in the EU-EEA countries range from 0% (Denmark) to 34% (Lithuania).  

All EEA countries are obliged to adapt their domestic laws so that the same bidding rules are applied throughout the area and tender systems are made completely open to participation from all member countries. Although Art. 45 of Directive/2004/18/EC on the award of public contracts in works, services and supply (the “Public Sector Directive”) instructs countries to debar enterprises convicted of corruption from participation in public procurement bidding for the whole area, suppliers located in quite corrupt countries can participate on equal footing with enterprises from low corruption countries and compete for procurement contracts located in both high or low corruption areas. Given the lack of an EU facility for monitoring corruption across member states it would be difficult to estimate the impact of this form of competition for the allocation of corruption propensities: would there be a leveling towards higher or lower average corruption rates, or a still wider gap in the incidence of corruption among member states? 

There is not much research on this issue, not least because of the absence of empirical data. In an interesting article, Ganuza and Hauk (2004) discuss the issues arising from the need for EU member countries with a wide variation in corruption propensities to agree on a set of common procurement rules. The authors construct a political economy model that aims to predict forces that may cause countries to leave or enter the union, or in other words, identify which countries have the strongest reasons for preventing particular newcomers. At the same time, their model predicts an overall decline in corruption rates.

Ganuza and Hauk’s model is too complex to be retold narratively; it is hardly realistic and should perhaps only be interpreted metaphorically.

133 An impression of the lack of precision in these estimates is given when it is noted that while Lithuania is ranked as tangibly less corrupt than Bulgaria on the perception index (46 against 73), citizens in Bulgaria report a substantially lower rate of bribe paying (8% against 34%).

134 However, member states “may provide for a derogation from the requirement referred to in the first subparagraph for overriding requirements in the general interest.” (Art. 45(1), second indent).

135 For further discussion on this see Center for the Study of Democracy (2011b).

136 This question is, in some ways, related to the more widely discussed question of whether the establishment of the same competition arena for enterprises located in countries with different wage levels and social labour standards. In the latter case, most of the advantages accrue to countries with lower wage levels and so a downward leveling should be expected. The advantages of being located in high corruption countries are less obvious.
However, it combines different factors likely to be important for developing pressures towards increasing or decreasing corruption rates away from initial equilibria. To simplify, they restrict the formal analysis to two countries. The officials who make the procurement decisions may either purchase the good/asset directly from a supplier, or they may have to arrange a costly tender paid by the government. All purchases without tenders are allocated to domestic firms. If a tender is announced, suppliers from both countries have access to the bid competition even before the citizens are presented with the choice of going for a union between the two countries or not. The costs for the officials of engaging in corrupt transactions are different in the two countries.

The officials are monitored by an electorate represented by a median voter who decides the rules for applying different procurement methods depending on the size of the procurement. The projects, including the costs of their procurement, are financed by taxes paid in full by the electorate represented by the median voter. The median voter holds some shares in the domestic enterprises but would not receive the whole profit. Eventual bribes would be received by the officials only who are not part of the electorate. Somewhat unrealistically, the officials are only able to collect bribes on projects that are below the tender threshold and supplied by low cost firms that could still expect some net profit after paying the bribes.

Utility maximization on the part of the representative voters in the two countries would then give lower optimal threshold in the high corruption country, since the gains from the lower procurement costs with a higher threshold would not compensate for the increase in corruption. That is, it would not be optimal for the voters in the two countries to have the same procurement rule. Despite its higher threshold of discretion, aggregate corruption is higher in the country with the more corrupt bureaucrats.

What would happen if the two countries were to create a union and share the same procurement rule? Each country would still supposed to pay for their own procurement by its own taxes but the profit of foreign enterprises would now be counted in the utility of each country’s median voter.

Ganuza and Hauk demonstrate that any feasible procurement rule – a rule that keeps the electorate better off after the union – would result in a threshold even lower than the optimal threshold of the high-corrupt country. If feasible, the lower thresholds of discretion would cause reduced corruption in all countries.

While both countries would gain from trade, the procurement costs of the low corrupt country would increase more. The more corrupt the potential new country member is, the higher the increase. If too corrupt, feasible common rule may exist or the low corrupt country may either refuse the new member to join, or it would withdraw itself. These results would be modified if the productivity of the low corruption country is higher than in the high corruption country. Then it would gain more by
the increase in international trade implied by the lower thresholds and therefore be more willing to accept corrupt partner countries.

Based on these considerations, Ganuza and Hauk formulated the following empirical political economy hypotheses: 1) More corrupt countries are more favorable towards economic union; and 2) The more corrupt the potential member country, the less acceptable for membership it would be. The authors explored the hypotheses with a small statistical model, where they combined the answers to a couple of questions from the standard Eurobarometer surveys indicating the attitudes in the different relevant countries towards the EU with their TI CPI values. Taking into consideration several statistical traps, they receive some empirical confirmation of their hypotheses.

The actual mechanisms in the model appear of course extremely unrealistic. The one perhaps most difficult to accept is the importance ascribed to thresholds with the assumption that most corruption takes place in the small-scale projects that are below the thresholds. In fact, or at least commonly assumed, corruption is a more serious issue among large projects above the thresholds.

It is commonly assumed, and a number of empirical studies tend to support the assumption, that more open economies tend to become less corrupt. The intuition here is that international competition will drive bribes down. Yet, this is not so obvious as stated in many policy contexts because, as pointed earlier, any public procurer is in a temporary monopsonistic position. Moreover, the purchasing agency has few possibilities to resell the goods it acquires, so one may expect price discrimination strategies even for quite homogenous goods. Modern economic analysis of corruption began, in fact, with a procurement model where the bidders possess similar technologies but where the highest bribe giver, who is also the least averse to corruption, wins the bid (Rose-Ackerman, published in 1975 and also in Rose-Ackerman, 1978). When bidding competitions become international, bidders from high corruption countries would be winners, and the EU enterprises from former socialist countries would have an advantage (and production in these countries should be stimulated with corrupt procurers). In another model of corruption as a bid competition, Lien (1986) assumes that all bidders are equally willing to bribe. The winner then is to the most efficient enterprise. Within the EU that assumption would not hold. If public officials are equally corrupt over the whole area, but enterprises from low corruption countries will be less willing to bribe, the enterprises from high corruption countries will win a higher share of the bids than the initial efficiency distribution would predict. If the distribution of the willingness to bribe is the same for all countries, but the public officials demand for bribes differ, there will be a redistribution of producer rent from low to high corruption countries.

A more realistic scenario would assume that: 1) in the initial situation high corruption countries have a stock of low efficiency suppliers with high willingness to bribe, while low corruption countries possess a stock of high-efficiency suppliers not used to bribe; 2) there are increasing
returns to scale. What is then likely to happen is that enterprises from the low corruption countries would expand into the high corruption area. Their profits and the bribe income of officials in the high corruption area would increase while the profits and size of the enterprises initially located here would shrink.

Alternatively, it could be hypothesized that the access of enterprises from high-corruption countries would increase the corruption propensities of procurers located in low-corruption countries. Although this would be possible if offering bribes to formerly non-corrupt officials in the low-corruption area becomes part of the survival strategy of the suppliers in the high-corruption area, but this is a more far-fetched hypothesis than the former one.
CONCLUSION

This paper analyzed various governance issues related to public procurement illustrated mainly through examples from Norway, a low-corrupt country. The emphasis has been on corruption and cartelization, as well as on how they are related. While only semi-public in nature, the institutional solutions from the Norwegian oil industry have had strong influence on Norwegian public management thinking, in general, and public procurement, in particular. The case of Norway has illustrated certain tradeoffs: bidding principles that may fight corruption may stimulate cartel-making or industrial espionage.

The rigidity of rules necessary to fight corruption could, in its turn, stifle innovation. Together with its complexity, the present procurement regime tends to create an organizational layer between the actual service deliverers in the public sector and the private suppliers, which tends to become centralized and dominated by economic and judicial thinking. **This centralization and the need to reduce the transaction costs of procuring could generate cartels** by limiting the number of organizations which are sufficiently professional when bidding and competing in accordance with the rules. **When bidding becomes international, so could cartels.**

Underlying the increased policy concern with public procurement is a strong tendency towards leaner organizations both in the private and the public sector. This entails that they have larger interfaces with other organizations. **When the nature of the tasks demands cooperation, hard money has to pass from one organization to the other.** If the task could be solved internally, only accounting relationships need to be established. **When money flows and is monitored by separate auditing arrangements, the risk for corruption increases.** This increased possibility for corruption is reinforced when the suppliers consist of a patchwork of separate subcontractors, where a supplier becomes head-procurer, creating divided or loosened loyalties. The competitive forms of procurement applied in the public sector – since the procurer will otherwise have low price elasticity – create strong motives for winning among the suppliers, inducing suppliers to create strong result-based incentives internally, which again could tempt agents of the suppliers to bribe. Since normally there should be more than two suppliers at each competition, agents would, on average, lose more often than they win.

From one perspective both cartelization and corruption may be considered as attempts by suppliers to soften the otherwise extremely harsh incentives created through bidding contests where only the winner may gain and the other bidders are doomed to loose. At present, strong political support exists for the reliance in many government administrations on such harsh incentives, stimulating cutthroat competition at the edges of the public sector. This kind of support does not take into account, however, that **the presumed efficiency of competitive mechanisms is**
based on a price system that induces agents’ efforts to work in parallel – something that is highly unlikely in this context. Thus, a large share of the competitive efforts here is likely to be expended in ways likely to destroy or thwart the competitors.

Social and economic forces have increased the importance of public procurement processes in most modern, developed countries. They have evolved as part of what is thought of as the modernization of the public sector with its out-sourcing tendencies. By taking examples from Norway, a fairly well-governed society, the paper illustrated the difficult governance issues that arise as a result. Such issues are believed to be even more difficult to solve in a country like Bulgaria.

A final word need to be said about statistics. It is striking that a country such as Norway lacks appropriate aggregate statistics of one of the most important social and economic developments that has taken place recently. While precise records of the number of, say, goats are being kept, the total number of government-procured consultants in Norway is unpublished, if at all counted. Thus, little is known about the empirical effects of such clearly defined variation in institutional rules as the ones developed for public procurement. This could indicate that most of the so called New Public Management movement is not exactly striving for a streamlined public sector based on a commitment to improve the living conditions for its citizens, but is rather an ideological construct.

While it is understandable that it is politically tempting to claim that choices between policy options are straightforward – and there are practically none when it comes to governance issues – an analysis of the drivers that motivate economic agents shows that no clear-cut model ensuring both perfect competition and flawless integrity exists. Policies that achieve both to a satisfactory degree require a constant flow of detailed feedback information and an open acknowledgement of the costs and benefits involved in choosing between options.
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