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## **CORRUPTION IN THE PUBLIC PROCUREMENT IN RUSSIA**

### ***Abstract:***

*In this article, we look at the reasons why the public procurement reforms in Russia have not been a success so far. The reform in the public procurement system was aimed at creating an anti-corruption mechanism and includes the following measures: introduction of electronic auction procedures, elimination of pre-qualification stage from the procurement procedure, increase in the degree of procurement transparency by creating an official public procurement web portal. Our empirical study shows that despite the reforming process there are still a lot of corruption-related risks in procurement procedures. The main negative effect of the public procurement reforms in Russia is the high risk of low-quality service provided by the contractors and low total efficiency of public spending.*

State procurement is one of the largest segments of the Russian economy. At the same time experts identify public procurement as one of the areas most prone to corruption. According to experts' estimates the Russian budget loses from \$5 billion to \$7 billion as a result of corruption. The major industries

where corruption prevails are construction of building and roads, medicine (procurement of pharmaceuticals and medical equipment) and scientific research services. Corruption scandals frequently involve public procurement. As an example to illustrate this point we can use the widely known fact of purchases of tomographs in some regions of Russia in 2010. The price of tomographs delivered for the state needs reached 90 million rubles although the manufacturer's price was only 16 million rubles.

There is a wide range of corruption-related actions on the part of both the public customers (state officials who make decisions about procurement) and the suppliers of goods and services.

Fraud and corruption-related actions, that are typical for the public customers in Russia, include the following:

- *Taking a bribe as an award.* Unfortunately it is very difficult to prove the fact of taking a bribe. However the survey made by the Higher School of Economics showed that to the question «How often do enterprises of your industry have to give bribes to receive public or municipal orders?» 17 percent of respondents chose the response «practically always» or «often», 22.5 percent of the companies said «sometimes»[5,13].

- *Slanted contract specification.* Slanting contract specifications by the public customers restricts the numbers of participants by using technical characteristics which give a favor to a particular supplier. According to the Federal Antimonopoly Service of the Russian Federation in N.Novgorod region, the rate of infringements of this kind was about 24 percent in the total number of infringements in N.Novgorod region in 2010.

- *Unjustified rejection of the participants' bids.* According to the Federal Antimonopoly Service of the Russian

Federation in N.Novgorod region, the rate of infringements of this kind was more than 46 percent in 2010 as compared to 30 percent in 2009 году. It is important to note that not all infringements revealed by the Antimonopoly service can be classified as fraud or corruption-related actions. In many cases the public customers simply try to choose a qualified and reliable contractor.

- *Breach of confidentiality.* This problem is typical for the purchases of goods and services for less than 500 thousand rubles, which are made using the procurement procedure «request for proposal». To solve the problem such procurement procedures will be shifted to the electronic auction portal in 2011.

- *Lax contract administration.* A public customer can accept poor contractor performance neglecting the state needs upon arrangement with the contractor.

- *Overestimation of the initial price.* Absence of methodology for determining the initial price may lead to its overestimating. In most cases the low level of competition doesn't lead to reducing of the price to a reasonable value.

Corruption-related actions typical for suppliers of goods and services are the following:

- *Offering a bribe as an award.* As it has already been mentioned, the fact of offering a bribe is usually hard to prove.

- *Bid rigging.* The term refers to the situation when the suppliers get together in order to “rig” the bidding context.

- *Giving false information.* The bidders can agree to fulfill all quality requirement of the public customers regardless of the real possibilities. As a result at the stage of contract performing they can not execute a contract fully and properly.

The aim of public procurement reforms in Russia is to design a mechanism of preventing fraud and corruption in the public contracting. The main rules and procedures of the modern procurement system were established by the Federal Law no.94-FZ of July 21, 2005 “On placement of orders to supply goods, carry out works and render services for meeting state and municipal needs”. The law is aimed at increasing the quality and transparency of public procurement policy and includes the following anti-corruption measures:

- Creation of official public procurement web portals;
- Elimination of pre-qualification stage from the procurement procedure;
- Introduction of auction procedures (from 2011 all auctions should take place in special electronic marketplaces).

*Creation of official public procurement web portals.* Initially three levels of official web portals were created: federal, regional, municipal. These portals provide guaranteed access to information and make sure that bidding documents and procedures are publicly and timely available. From 2011 the new single Russian-wide portal [www.zakupki.gov.ru](http://www.zakupki.gov.ru) has been created. Availability of the single information source considerably reduces the risks connected with unplacing or garbling of information. Additionally the media and interested individuals are able to monitor government purchases.

*Elimination of pre-qualification stage from the procurement procedure.* The pre-qualification stage is widely used in foreign practice. The purpose of it is to decide whether the candidate is qualified or not to perform a contract. The advantage of the pre-qualification procedure is that the procurement entity can choose a sufficient number of qualified suppliers. The disadvantage is the

following: during the pre-qualification stage officials have the flexibility to make decisions if the supplier is qualified or not. In order to avoid corruption the reformers have eliminated this procedure in all cases except for the contracts worth more than 50 million rubles in the building branch. In this case the public customers are allowed to use the qualification criterion - work experience. So we can see the dichotomy between preventing corruption on the one hand and efficiency and quality of public purchasing on the other hand.

*Introduction of auction procedures.* In comparison with the tendering procedure where there are usually at least two criteria (for instance price and quality), at an auction the only award-criterion is the lowest price. The advantage of an auction is the opportunity to track the current price level on the market, involving the maximum number of suppliers regardless of the experience and qualification. Introduction of auction as a preferable procedure makes the Russian procurement system quite different from international standards. On the top of this, Russian legislation permits using very few procurement procedures of those, widely spread in world practice. Table 1 gives a summary of the range of procurement methods of international organizations and Russia. As it follows from Table 1 the auction procedure is not used in international practice.

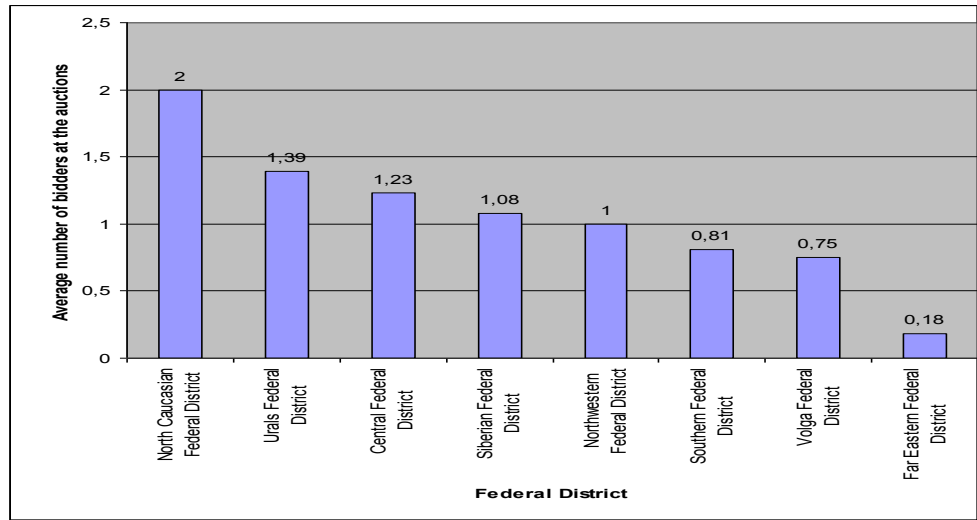
EU (WTO)	UNCITRAL <sup>1</sup>	World Bank	Russian procurement system
<ul style="list-style-type: none"> <li>• Open procedure (open tendering)</li> <li>• Restricted procedure (Selective tendering)</li> <li>• Negotiated procedure (Limited tendering)</li> </ul>	<ul style="list-style-type: none"> <li>• Tendering</li> <li>• Restricted tendering</li> <li>• Two-stage tendering</li> <li>• Request for proposal</li> <li>• Competitive negotiation</li> <li>• Request for quotation</li> <li>• Single-source procurement</li> </ul>	<ul style="list-style-type: none"> <li>• International competitive bidding</li> <li>• Limited competitive bidding</li> <li>• National competitive bidding</li> <li>• Shopping</li> <li>• Direct contracting</li> <li>• Force account Request for proposal</li> </ul>	<ul style="list-style-type: none"> <li>• Open and selective tendering</li> <li>• Open electronic auction</li> <li>• Selective auction</li> <li>• Request for proposal</li> <li>• Single-source procurement</li> </ul>

Table 1 - Summary of procurement methods

As a result of the new procurement legislation the creators expected an increase in the level of competition. Unfortunately the empirical study shows the opposite result. The research team of the Public Administration Department of the State University - Higher School of Economics in Nizhny Novgorod headed by the author made a survey for a local oil company. The study shows that the average number of bidders at the municipal auctions ranges from 0,18 to 2 (study of the market of oil products). The average initial price was 469,49 thousand rbl., while the average price of the signed contracts was 432,71 thousand rbl. As we can see, the average price of the signed contracts doesn't differ a lot from the initial price. So,

<sup>1</sup> United Nations Commission on International Trade Law (UNCITRAL) Model Law provides a “menu of options” from which states may choose and incorporate into their legislation.

the average size of price reduction is about one percent.



Picture 1. Average number of bidders at the municipal auctions in the Russian Federation in 2009 (market of oil products)

Although researchers took into account only municipal purchasing but we found these results representative. An obvious conclusion of the research is that the level of competition at the auctions market of oil products is quite low. The main reason is bid rigging and other corruption related risks.

So trying to avoid collision between the tenders and state officials we get collusion between suppliers. This process might be called the “vicious circle” of corrupt procurement practice.

Usage of internet service for carrying out auctions introduced in 2011 provides an opportunity to solve the problem of suppliers rigging. It is a rather effective instrument against “home” tenders. The electronic auction eliminates the possibility of negotiation between the public authorities and suppliers as well as among suppliers. But technical and financial requirements connected with participation in electronic auctions are too strict. It makes

procedures of accessing the tender competition very complicated and expensive (especially for small business).

As a result, according to the Federal State Statistics Service of the Russian Federation for 2010 about 26 percent of total purchasing budget in the quantitative expression and 45 percent in the cost expression were allocated without any competition.

The mechanism of electronic purchases has another essential drawback. It is suitable only for the purchase of standard, typical goods and services. Therefore, an important aspect of introducing electronic auctions is identifying goods and services that are suitable for e-commerce.

John Krogstie points out that it is possible to support approximately 30% of the purchases (money-value) with the electronic procedures. These purchases typically represent about 50 percent of the total number of purchases.[1,204] To cut down risks in the process of buying complicated products (services, works) it is necessary to take into account the qualification of suppliers.

To sum up we agree with those who consider procurement reforms a tool for fighting corruption. But we have to mention the main negative effects of the public procurement reforms in Russia:

- Having to deal with financially weak contractors and inadequate qualifications of bidders. As a result, cash flow problems of financially weak contractors turn up frequently in the crucial final stage of the job;
- Complicated procedure of accessing the electronic auctions competition (especially for small business), that leads to competition decrease;
- Reduction of total efficiency of public spending (public customers have to emphasize the control over the procedure



performance but not the quality of services provided by the contractors).

The procurement reforms highlight the tradeoffs between avoiding corruption and giving the state officials the flexibility to make decisions in terms of efficiency. The Russian legislation on public procurement might be perceived not only as fighting corruption, but also to some extent fighting quality and professionalism.

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