



The wiiw Balkan Observatory

Working Papers | 120 |

March
2016

Elizabeth Dávid-Barrett, Vladimir Gligorov and Jelena Krstić

Corruption Risk and Legitimacy in Outsourced
Public Service Provision: Evidence from Serbia





The wiiw Balkan Observatory

www.balkan-observatory.net

About

Shortly after the end of the Kosovo war, the last of the Yugoslav dissolution wars, the Balkan Reconstruction Observatory was set up jointly by the Hellenic Observatory, the Centre for the Study of Global Governance, both institutes at the London School of Economics (LSE), and the Vienna Institute for International Economic Studies (wiiw). A brainstorming meeting on Reconstruction and Regional Co-operation in the Balkans was held in Vouliagmeni on 8-10 July 1999, covering the issues of security, democratisation, economic reconstruction and the role of civil society. It was attended by academics and policy makers from all the countries in the region, from a number of EU countries, from the European Commission, the USA and Russia. Based on ideas and discussions generated at this meeting, a policy paper on Balkan Reconstruction and European Integration was the product of a collaborative effort by the two LSE institutes and the wiiw. The paper was presented at a follow-up meeting on Reconstruction and Integration in Southeast Europe in Vienna on 12-13 November 1999, which focused on the economic aspects of the process of reconstruction in the Balkans. It is this policy paper that became the very first Working Paper of the wiiw Balkan Observatory Working Papers series. The Working Papers are published online at www.balkan-observatory.net, the internet portal of the wiiw Balkan Observatory. It is a portal for research and communication in relation to economic developments in Southeast Europe maintained by the wiiw since 1999. Since 2000 it also serves as a forum for the Global Development Network Southeast Europe (GDN-SEE) project, which is based on an initiative by The World Bank with financial support from the Austrian Ministry of Finance and the Oesterreichische Nationalbank. The purpose of the GDN-SEE project is the creation of research networks throughout Southeast Europe in order to enhance the economic research capacity in Southeast Europe, to build new research capacities by mobilising young researchers, to promote knowledge transfer into the region, to facilitate networking between researchers within the region, and to assist in securing knowledge transfer from researchers to policy makers. The wiiw Balkan Observatory Working Papers series is one way to achieve these objectives.



The wiiw Balkan Observatory

Global Development Network Southeast Europe

This study has been developed in the framework of research networks initiated and monitored by wiiw under the premises of the GDN–SEE partnership.

The Global Development Network, initiated by The World Bank, is a global network of research and policy institutes working together to address the problems of national and regional development. It promotes the generation of local knowledge in developing and transition countries and aims at building research capacities in the different regions.

The Vienna Institute for International Economic Studies is a GDN Partner Institute and acts as a hub for Southeast Europe. The GDN–wiiw partnership aims to support the enhancement of economic research capacity in Southeast Europe, to promote knowledge transfer to SEE, to facilitate networking among researchers within SEE and to assist in securing knowledge transfer from researchers to policy makers.

The GDN–SEE programme is financed by the Global Development Network, the Austrian Ministry of Finance and the Jubiläumsfonds der Österreichischen Nationalbank.

For additional information see www.balkan-observatory.net, www.wiiw.ac.at and www.gdnet.org

Corruption Risk and Legitimacy in Outsourced Public Service Provision: Evidence from Serbia

Elizabeth Dávid-Barrett, Vladimir Gligorov, Jelena Krstić

ABSTRACT

The provision of public services is an important way for weak states to build legitimacy, as long as the public regards the allocation of resources as impartial and fair. However, in societies where resources have long been distributed according to particularist and informal ties, it may be difficult to ensure an impartial allocation. We argue that the challenge of using service provision to build state legitimacy is complicated by the wider trend towards increasing private provision of public services. This makes it harder to hold the state to account for service provision, especially in transition and developing-country contexts where the distinction between the public and private spheres is in any case blurred. To explore these issues in the context of Serbia, the paper focuses on the public procurement process. We discuss process and outcome indicators of corruption risk in Serbian public procurement, assess the institutional control framework, and consider four recent cases of irregularities that are indicative of corruption risk.

Keywords: public procurement, outsourcing, corruption, patronage, legitimacy, transition, accountability

Corruption Risk and Legitimacy in Outsourced Public Service Provision: Evidence from Serbia

PUBLIC SERVICES AND STATE LEGITIMACY

In political theory, the state has traditionally been seen as a ‘natural’ provider of public goods for four reasons. First, because the state has a monopoly over the use of force, it is in a good position to extract the resources needed to provide collective goods to the population (Fukuyama 2004; Rotberg 2004). Second, its coercive power allows it to enforce rules that govern the provision of collective goods. Third, the state’s ability to generate economies of scale mean it is well placed to deliver services that have high marginal start-up costs, the classic case being infrastructure. Fourth, the state has the ability to play a coordination role which is often necessary for service provision.

By contrast, where states are weak - i.e., lacking the ability to control their territory, extract resources from the population or to enforce rules - they may not be the most suitable providers of public services. The prevalence of weak states in the developing world has often been identified as a barrier to growth; correspondingly, ‘state-building’ has emerged as a new paradigm for development (Marquette and Beswick 2011). In transition countries too, states are often weak, and the dual economic and political transformation processes require the building of new institutions (Linz, Stepan, & Gunther, 1995). This paradigm has therefore underpinned the approach of

donors providing aid and technical assistance to countries in South-eastern Europe, including Serbia (Carothers, 2010).

However, the provision of collective goods is also seen as a critical condition *for* state-building according to a prevailing argument that, by building a reputation for delivering services that people need, state institutions can build legitimacy (Batley and McLoughlin 2010). States need legitimacy in many forms - geographical legitimacy to maintain the integrity of borders, and political legitimacy to help them collect taxes, enforce laws and avoid major challenges to their power (Held 1996; Leftwich 2000). The implication is that weak states *should* engage in service delivery because it will help them to build legitimacy and thus become more effective.

Yet the evidence is mixed. One major review found that service delivery could contribute positively or negatively to state-building, and noted that there was a lack of evidence about the conditions in which positive contributions could be assured (Ndaruhtse et al 2011). Haider (2010) argued that the potential for service provision to help build state legitimacy depends on effectiveness, accountability and fit with social norms. McLoughlin (2015), in her work on public services in post-conflict and fragile states, finds that the relationship between the state's performance on service provision and its legitimacy is conditioned by several ideational and relational factors. These include expectations of what the state should provide, subjective assessments of impartiality and distributive justice, how easy it is to attribute (credit or blame) performance to the state, and the characteristics of the service.

Building on McLoughlin's findings, we suggest that perceptions that the state's provision of public services is unaccountable or prone to corruption may undermine efforts to build legitimacy. In doing so, we contribute to the debate on how informal norms in certain societies may perpetuate corruption and undermine anti-corruption efforts. Rothstein (2011) argues that anti-corruption efforts often fail where corruption is widespread because of a collective action problem: if an actor believes that everyone is corrupt, it is not rational to seek to hold corrupt actors to account, since this would just limit his or her own access to resources. This means that efforts to fight corruption which lead to scandals being revealed might, perversely, perpetuate expectations that in turn foster corruption (Krastev, 2005).

In many Central and South-east European countries, a history of clientelism and informality mean that strong social norms exist that resources should be allocated according to particularist rather than universalist concerns (Mungiu-Pippidi, 2005). This creates widespread expectations that individuals occupying state roles will misuse their office to allocate resources to their informal social networks. Indeed, individual public officials even regard these practices as legitimate or at least justifiable when the state is ineffective (Grodeland and Aasland 2011). This suggests that the tasks of building capacity and legitimacy for the state in South-eastern Europe may be continuously undermined by corruption.

THE OUTSOURCING OF PUBLIC SERVICE PROVISION

The prevalence of the state-building paradigm partly reflects a view that institution-building played an important role in the economic development of many OECD

countries (North 1990). Yet in many of those countries, state provision of public services has receded as successive governments have adopted ‘new public management’ (NPM) theory, which posits that the introduction of market forces into public service provision brings efficiency gains (Hood 1991). The state has withdrawn from many areas of direct service provision and instead engages only in its *management*. A number of new types of relationship with the private sector have arisen. In privatization, state assets are sold to private companies which then operate in market conditions. In private finance initiatives (PFIs), the private provider incurs upfront investment costs but shares risk with the state and sells services over the life of the project. In outsourcing, the state defines the terms of a contract and then engages a company through the public procurement process, typically through a competitive tendering process. The state thus retains a key role in managing the process, e.g., by setting the terms of a tender, selecting the winning bidder, and then continuing to engage in contract management. As such, state capacity continues to be important even under NPM.

Despite ambiguous evidence as to whether NPM delivers the purported benefits (Hood and Dixon 2015), politicians often support private-sector involvement in public service provision as a way of managing tight public budgets. In transition and developing countries, this argument is equally valid, if not more so. The introduction of private investment promises to help overcome obstacles to service provision that arise from a country having a weak fiscal position, limited capacity to borrow, or gaps in technical knowhow. Infrastructure, for example, is critical for economic growth, but requires major up-front investment, which countries with scant ability to raise money from taxes or on capital markets are ill placed to finance. Private financing of

transport infrastructure can enable states to launch major projects that would not otherwise be feasible.

However, the profusion of public-private partnerships also raises questions about the capacity of these states to manage or regulate the process, and to do so in an accountable way. The accountability challenges are exacerbated in a transition context where risk management is poor (Handley-Schachler & Gao 2003) and because a clear separation between the state and the private sector was never fully established (Ganev 2007; Jones 2013; Wedel 2004). Moreover, the outsourcing of public services delegates new forms of discretionary power to public officials that are already embedded in a clientelist context (Blunt, Turner, & Lindroth, 2012; Jing, 2008). There is thus a risk that procurement processes will be highly prone to favouritism and corruption. Indeed, public officials may become expert in using the regulation around procurement to facilitate but conceal favouritism, by manipulating the process so as to give the appearance of open competition. We further suggest that this undermines state-building and hinders efforts by parts of the state to build legitimacy by delivering public services.

We investigate these issues by analysing public procurement in Serbia. We conducted research in three phases: an ‘audit’ of the legal and institutional environment in which public procurement occurs; interviews with experts involved in executing and monitoring procurement; and analysis of case studies where conflicts of interest or particularism appear to have hindered service provision. The paper proceeds as follows. First, we provide an overview of common corruption risks in public procurement. Second, we focus on the evidence of corruption risks in Serbia,

in terms of both process and outcomes. Third, we discuss three recent case studies where public procurement has been associated with corruption allegations. Fourth, we evaluate the institutions charged with ensuring accountability in public procurement and identify areas for improvement.

CORRUPTION IN PUBLIC PROCUREMENT

Public procurement or government contracting is prone to corruption in both Western and Eastern Europe (OECD 2006; Grodeland 2006). The public procurement process can be manipulated for personal or political gain in a number of ways, by the public officials executing the process, by collusive strategies among bidding companies, or through collaborative schemes involving both the demand and supply sides. Research on the Serbian case (OSCE 2014) suggests that corruption occurs in all phases of the procurement process - during planning, tender, or post-contract award.

In the planning phase, corruption risks include unnecessary procurement, i.e., buying goods or services that are not needed or are of an unnecessarily high specification; mis-estimating the value of a contract; contract splitting, so as to avoid the need for competitive bids or to avoid scrutiny; excessively detailed specification of needs, so as to exclude certain bidders and favour a preferred bidder; unjustified use of exceptions in the law, which, for example, allow non-competitive or emergency procedures; the launch of tenders that are not in line with the procurement plan. During the tender, corruption might include undeclared conflicts of interest, vague or contradictory content of the tender documentation (allowing some bidders to be excluded on technical grounds, or deterring bidders), discriminatory requirements for

participation of bidders, irregularities related to the publishing of contract notices or provision of tender documentation, discriminatory criteria for the selection of the best bid, or collusion among bidders to ‘ration’ contracts among themselves. Following award of the contract, corruption might include turning a blind eye when a contractor fails to execute the bid in a way that differs from the contract, failing to impose penalties for non-fulfilment of contract obligations, re-negotiation of contracts to provide more favourable terms to contractors.

It is not straightforward to measure corruption in public procurement because those involved often have both the incentives and the power to conceal their actions, meaning that irregularities are not always identified – or revealed - even by auditors.

Even if corruption does come to light in individual instances, it is difficult to assess whether they are representative of wider patterns. However, recent work by the EU-funded ANTICORRP research programme has developed a range of indicators of favouritism in public procurement by focusing on certain aspects of the *process* (e.g., excessive use of procedures which restrict competition to sole bidders or unnecessarily tight specification of requirements), as well as *outcomes* (e.g., winning bidders have strong political connections or win only in combination with certain other bidders) (Fazekas, Toth and King 2013).

These indicators are used to study public contracting in the construction sector in a range of countries, including south-east European countries where particularism is the norm, such as Turkey, Croatia and Bulgaria (see Mungiu-Pippidi 2015). The research suggests that the nature of public procurement corruption varies depending on

underlying conditions, including the level of political competition, the prevailing methods for distributing resources along informal networks, the extent to which a functioning and competitive private sector exists, and the nature of institutional controls (Emek and Acar 2015; Fazekas and Lukacs 2015; Stefanov and Karaboev 2015; Podumljak and David-Barrett 2015).

PUBLIC PROCUREMENT IN SERBIA

The value of public procurement in Serbia was 10% of GDP in 2010, up from 7.4% in 2005, and representing an increasingly important part of the economy (Rikalovic et al 2012). Public procurement is governed by the Law on Public Procurement, first introduced in 2002 but amended several times subsequently to address various weaknesses, many of which were related to corruption risks. These included narrowing the scope to use negotiated procedures without prior notice, more carefully defining the conditions for confidential and defence procurement, improving the capacity of monitoring institutions, and introducing a right to launch a misdemeanor procedure (Rikalovic et al 2012). The latest version of the law was passed in 2013.

In terms of corruption risk indicators on procurement processes and outcomes, the picture in Serbia is mixed.¹ One indicator of corruption risk is the frequency with which non-competitive procedures are used for procurement. Where contracting authorities frequently use procedures which restrict competition, this might indicate

¹ These data are taken from Public Procurement Report for 1.1.14- 31.12.14, Public Procurement Office, April 2015, available here: http://www.ujn.gov.rs/ci/izvestaji/izvestaji_ujn

that steps are being taken to favour a certain firm. By 2014, this does not seem to be a major problem in Serbia, since 85% of tenders were conducted according to competitive procedures, and only 5% through negotiation without announcing a tender (plus 10% using other procedures). However, this represented a rapid improvement on previous years: 37% of tenders by contract value had been conducted through negotiated procedures in 2007, as had 28% in 2012. The change might reflect institutional reforms in the intervening period, in particular a new requirement that contracting authorities consult the Public Procurement Office before opting for a negotiated procedure. This additional control might have deterred public officials from using this method to allocated contracts corruptly.

In an environment where corruption is commonplace, some companies choose not to invest time and resources in bidding for tenders, because they regard it as a waste of resources in a context where (they perceive that) the winning bidder is pre-determined. This would be reflected in low numbers of bidders for contracts. Over time, such perceptions can drive companies out of the market, so that alternative bidders do not even exist. There is some cause for concern in this regard in Serbia, with the average number of bidders at only 2.6 in 2014, on a downwards trend (see Table 1) and well below the EU average of 5.4. Indeed, in a high - and growing - proportion of contracts, there is only one bidder. Table 2 shows the percentage of contracts that were signed in open tenders where only one offer was received.

Table 1: Average number of bids per tender, by year

2011	2012	2013	2014
3.2	2.7	2.7	2.6

Table 2: Percentage of contracts let in tenders with a sole bidder, by year

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
%	13.8	18.1	27.2	26.9	28.6	31.3	30.7	34.6	39.7	41.8	36.8	42.6

Recent research by Transparency International Serbia, based on 28 interviews, concluded that the main explanation for continuing low levels of competition for Serbian public contracts was a lack of trust in the procedures and institutions of the public procurement system. Their research revealed a widespread view that many contracting authorities often give privileged status to certain suppliers. In our interview research, anti-corruption experts and investigative journalists said that corruption is often arranged informally prior to the official procurement process being initiated; the official procedure is purely a show designed to legitimize a prior corrupt deal between the contracting authority (one or more public officials) and the contractor. Sometimes the existence of a prior deal might be discernible from the contracting authority's behavior as it launches a tender, e.g., by charging excessively high prices for tender documentation, specifying very narrow terms for the services required, or splitting tenders into smaller units so as to avoid rules about transparency or use of competitive procedures. Thus, in its review of 25 tenders conducted by the Prokuplje municipality in 2012-13, the Toplicki Center for Democracy and Human Rights, a civil society organisation engaged in corruption monitoring and prevention, found two cases where the price of tender documents had been set at 50,000 Serbian dinars, way above reasonable costs (and in breach of Article 31 of the Public

Procurement Law effective at that time). In two further cases, tenders had not been included in the municipality's Public Procurement Plan (contravening Article 27).²

Companies that bid for procurement contracts are often highly sensitive to such clues or indicators that a prior informal deal has already been struck, and may choose not to bid where they consider that resources would be wasted. One civil society representative that we interviewed commented that,

"there is a high degree of skepticism among suppliers about the way contracting authorities conduct tenders. This affects their willingness to take part. They believe the tenders are often arranged and that they shouldn't bother participating."

Such perceptions of corruption in public procurement can be highly detrimental not only to the legitimacy of state organisations, but also to market conditions and, ultimately, economic development.

Another way in which corruption occurs even before the procurement process starts is through the provision of informal guarantees. One expert that we interviewed expert explained,

"if the tender is for a bigger, riskier project, the contracting authority will give guarantees to its selected company that it will assist them if things go

² Toplicki Centre for Democracy and Human Rights, 2014, 'Civil Supervision of Local Public Procurement' report published as part of a wider project on 'Towards socially responsible local budgeting: Civil Society against Corruption in Local Public Procurement', funded by the Olof Palme centre.

wrong. They won't commit this way with any other companies, which will lead to reduced competition.”

Contracting authorities might favour selected bidders in this way for a variety of reasons, e.g., because the company has offered a kickback, because the public officials have a personal interest in the company, or because the company is a supporter of the political party in power.

Another potential indicator of corruption is the level of irregularities revealed by audits. The State Audit Institution reviews the budgets of a sample of contracting authorities annually. In its most recent review of 135 authorities, the SAI found that 73 were engaged in procurement that was in violation of the Public Procurement Law, in 363 individual cases to the value of 7.56 billion dinars. In 216 cases, contracts were finalised without even conducting a tender.

One of the experts we interviewed noted that public procurement plans produced by contracting authorities often include “round numbers”. This may suggest that the analysis of needs was not precise or that the budget was adopted prior to the procurement plan being drafted, rather than vice versa. Contracting authorities rarely undertake the required market research or make adequate assessments of their needs. This means that there is plenty of scope for individuals to abuse the process so as to channel a contract towards a particular bidder, and at the same time no real framework against which to scrutinize the conduct of either public officials or bidders. In some circumstances, weak or vague plans reflect a deliberate attempt to manipulate the process; in others, the initial vagueness is unintended but nevertheless

creates scope for corruption to occur unobserved. In yet other cases, weak planning may simply be an unintended consequence of weak capacity, but it then leads to unintended procurement outcomes.

Another interviewee noted that there are often significant differences between the prices foreseen in plans, those published in tender documents and those agreed with suppliers. Again, successive adjustments might reflect collusion among public officials and suppliers to manipulate the process, or simply inaccuracies in official estimates. The expert took the view that incompetence and weak capacity account for at least some of these irregularities, particularly in smaller contracting authorities that are under-resourced. Larger contracting authorities are usually not short of expertise and, in these cases, deliberate manipulations with corrupt intent seem more likely.

Bidders who perceive that their rights to compete for tenders have been violated in some way may submit a request for the protection of rights to the Republic Commission for the Protection of Bidders' Rights. The number of requests for such protection is significant and increasing, having grown by 39% year-on-year in the period from April (when the new law came into effect) until December 2013, and by 36% in 2014 compared to the previous year. In 2013, the Republic Commission reached 1,966 decisions on such requests, and its decisions led to procurement decisions being partially or fully annulled in 46% of cases. Most of the complaints received relate to tender documents, discriminatory conditions related to criteria, and discriminatory technical specifications.

However, such data are difficult to interpret since the propensity to complain varies. In countries where corruption is prevalent, companies and individuals often fail to report it owing to perceptions that this will prejudice their future efforts to win contracts or because they assume that the courts are in any case vulnerable to improper influence. Thus, when the number of complaints increases, this might not signal an increase in problematic cases but rather growing confidence in the institutions. Even where irregularities are found, it is not clear whether they reflect corruption or simply weaknesses in administrative capacity.

INSTITUTIONAL CONTROLS ON PROCUREMENT

Theory suggests that corruption is likely to occur in conditions where public officials have considerable discretionary and monopoly power, but lack accountability (Klitgaard 1988). We have suggested that growth in outsourcing tends to increase the discretionary power of public officials, particularly in transition societies where accountability institutions are not well established. However, transition societies are also engaged in processes of state-building which are partly directed towards building institutions that can help hold public officials to account. Thus, in assessing the exposure of public procurement to corruption, it is necessary to assess the nature of institutions that have a mandate to control and regulate procurement (Heggstad et al 2010).

Public procurement in Serbia is undergoing constant reform, motivated partly by the need to harmonise legislation with the *acquis communautaire* as part of the European Union accession process, and often supported by technical assistance from

international donors as well as local civil society organisations. The 2013 Public Procurement Law is widely regarded as a significant improvement on its predecessor, but nevertheless contains weaknesses that create scope for corruption.³ For example, while the commissions appointed by contracting authorities to oversee procurements are responsible for disclosing any conflicts of interest, the law does not specify when or how this should be done. Regarding amendments to tender documents before the deadline, the rules do not specify that enough time must be allowed for suppliers to make a complaint, if necessary, or the consequences if such rules are not respected. Moreover, the law is not sufficiently clear about which parts apply to tenders above the 400,000-dinar threshold and which do not. A more serious problem is that the law appears to be weakly enforced. Despite a high proportion of irregularities revealed by the SAI and a high number of complaints submitted to the Republic Commission, there have been no convictions for violations of the Public Procurement Law in Serbia, and very few criminal investigations have been initiated. This suggests a lack of political will to tackle corruption in contracting and is consistent with common tactics by which patronage networks resist reform (Blunt et al., 2012)

There is also an ongoing effort to build capacity among institutions that play a role in ensuring integrity in the procurement process. The Public Procurement Office (PPO) provides training to public procurement officials, as well as advice and telephone consultations to contracting authorities regarding procurement plans and the execution of procedures. It prepared and published the Internal Act Model and Internal Plan

³ The law is currently being reviewed again. Some of the experts we interviewed noted that there had been no public consultation on reform, no systematic analysis of the law's weaknesses, and that some proposed reforms threatened to increase the scope for corruption.

Model for fighting corruption in public procurement, in order to assist contracting authorities with developing internal documents and plans. It has also developed software for tender planning and quarterly reporting, together with a manual. The PPO also names civil supervisors to oversee public procurements valued above 1 billion dinars, although in other countries this has been identified as a way of facilitating corruption - by appointing 'trusted' advisors to such roles.

The Republic Commission for Protection of Rights in Public Procurement Procedure operates the PPO portal, where public procurement opportunities must be posted, as well as dealing with complaints filed by suppliers and monitoring implementation of its decisions. All suppliers have the right to complain about the public procurement process, at any stage. When a complaint is filed, the Commission halts the tender process in order to investigate. Complaints can be accepted (leading to annulment of the tender), rejected, or partially accepted. The Commission then monitors compliance with its decisions and can ask contracting authorities to provide reports or undertake inspections.

Experts that we interviewed were of the opinion that the Commission performs its duties well but has very limited resources. Some also argue that the Commission faces political pressure, for example, this respondent told us,

"It is quite clear that the Public Procurement Office and the Republic Commission are unable to sustain the political pressure. The recent resignation of the president of the Commission [...], best exemplifies how

dramatic these pressures are. This can also be seen by the sometimes legally dubious decisions made by the Commission.”

There may also be a problem with some law firms taking advantage of the complaint mechanism to increase business for themselves, encouraging clients to file complaints even when there are no legitimate grounds.

Clientelism in the management of human resources also undermines institutional learning. When a new administration takes office, it appoints its own people to positions of influence in ministries and other public-sector bodies. This creates the foundations for political influence over subsequent decision by those bodies, some of which include procurement decisions. However, it also has the effect of eradicating institutional memory and thus preventing learning in the civil service. Incoming ministers rarely make an effort to familiarise themselves with previous reform efforts, and often annul or suspend positive changes or processes that were initiated by the previous administration. For example, the Anti-corruption Agency in Serbia had for several years encouraged public-sector agencies to introduce Integrity Plans, whereby they assess their own performance and commit to achieving higher standards. Following a change of government, existing Integrity Plans were abandoned, perceived as the product of a past administration and hence not to be trusted.

In addition to the formal institutions monitoring the execution of public procurement procedures, two civil society organisations play an important role in scrutinizing the spending of public money and exerting pressure for further reform. Suppliers of Serbia has around 70 member organisations, which it represents by publishing reports

about their experiences, submitting requests for rights protection and organizing workshops to build capacity. The Coalition for Monitoring Public Finances is an association of NGOs that was established in 2005 to increase civil society's participation in public finance monitoring and thereby corruption reduction. The Coalition conducts research using the Freedom of Information Law, and reports on specific issues related to public procurement monitoring. It requests and scrutinizes information from contracting authorities about procurement plans, budget decisions, employment structure, suppliers that have won contracts, type of procedure used, content of annexes, and complaints submitted to the Republic Commission. Use of the Freedom of Information Law is critical because, in general, civil society efforts to scrutinize public procurement are hindered by poor disclosure of tender documents. Transparency International Serbia reports that many tenders are published without mandatory elements, such as annexes, weakening the ability of civil society to hold contracting authorities to account. Two media organizations known for their investigative journalism - the Balkan Investigative Reporting Network and the Center for Investigative Journalism Serbia - have uncovered major misconduct in public procurement. They often face severe criticism from other media and from the authorities, being labelled as 'foreign agents'. Few other media organisations report on such issues, perhaps reflecting their lack of financial independence or a lack of appropriate expertise.

CASE STUDIES

Case 1: Prokuplje Children's Playground

In Prokuplje municipality, irregularities indicative of corruption were identified at several stages of the process in a procurement of goods and services for a children's playground:⁴

- Contract splitting. The 2012 Public Procurement Plan had estimated the value of the contract at 9.6 million dinars. Given the rules in place at the time, the municipality would have been required to conduct an open tender for this contract, because it exceeded the threshold of 3.31 million dinars. However, the municipality instead split the contract into three separate tenders.
- Discriminatory specification. The commission established to award the tender adjusted the requirements for the supplier by requesting the exact product offered by the distributor of one supplier.
- Weak and suspicious competition. The same set of companies took part in all three tenders, but in two cases, the offers submitted by the two non-winning companies stated prices way above market value, possibly so that it would appear that their competitor had won fairly – a technique known as ‘cover pricing’. The commission executing the procurement had neglected its duties to investigate the market.

In this case, the prosecutor's office in Prokuplje charged the former president of the municipality with misuse of his official position; he was convicted and sentenced to 18 months' imprisonment and a fine of 150,000 dinars.

⁴ See Toplicki Center for Democracy and Human Rights for more details.

Case 2: Social Care

In October 2014, the Ministry of Labour, Employment, Veterans and Social Policy announced a tender for the Advancement of the Social Protection System in Serbia to the value of 226 million dinars (nearly 2 million euros). Funds were allocated to 122 organizations, each receiving 2 million dinars (approximately 16,370 euros). However, analysis of the winning bidders revealed a number of suspicious features⁵:

- Many of the recipient organisations had been established only very recently, while many long-established organisations in the field were not awarded funds. Of the 122 winning bidders, 61 had been established in 2014 and, of those, more than 50% had been set up in the month prior to the tender being announced. Several organizations were registered only after the launch of the tender.
- Almost 70% of the recipients had not previously been involved in the provision of social protection services. Some had worked in ecology, some in rural development, and one recipient was not registered at all.
- Several organisations had been established and/or were run by the same individuals.

Having revealed these irregularities, a group of NGOs filed a complaint against the Ministry, and specifically against individuals involved directly in the tender, citing

⁵ Blic “Vulin: Vucic ce odluciti o mojoj ostavic”, Blic News, 8th December 2014, <http://www.blic.rs/Vesti/Politika/517497/Vulin-Vucic-ce-odluciti-o-mojoj-ostavci>

conflicts of interest relating to one of the Ministry's advisors and one of the successful bidders. The complaint focuses on the need to determine whether the case represented abuse of office, and is supported by details from the communications between some bidders and Ministry employees.

In response to allegations that the Minister of Labour, Employment, Veterans and Social Policy had used the tender to allocate funds – earmarked for helping the elderly, sick children and the disabled - among his friends, relatives and party cronies, the minister said that he had played no role in the selection of the winning projects. However, soon afterwards, he annulled the budget item and allocated the funds to the Fund for the Treatment of Children's Rare Diseases; this decision that was also made outside normal procedures and apparently arbitrarily.⁶ Organisations with legitimate initiatives and plans were then required to wait until the next year for a new round of funding.

In the meantime, daily newspaper Blic published several articles about other irregularities in procurement at the Ministry. Blic alleged that the Minister spent 1.4 million euros on office furniture and computer equipment for Social Protection Institutions. The procurement was conducted through separate contracts undertaken by a number of state institutions and valued at 400,000 dinars, just below the threshold at which tenders must be open and competitive. The institutions were

⁶ This decision breached the rules of budget policy and the budget system law, since Vulin is not authorised to re-allocate those resources without consent from the minister of finance.

instructed to buy equipment from particular stores, despite the Ministry being officially prohibited from interfering in the choice of suppliers.⁷

Case 3: Electricity Meters

Another case concerns a lack of transparency in the planned procurement of electricity meters, an area with a history of irregularities. The Republic Commission for the Protection of Rights in Public Procurement Procedures has annulled at least ten tenders, following complaints by producers of electricity meters which have been on the market since the 1990s, including Belgrade-based company Enel.

The Commission found numerous irregularities with the tender procedures, and questioned the frequency with which the EPS used urgent procedures. Dragan Vasiljevic, the owner of Enel, alleges that most of the tenders were annulled because EPS was trying to favour Meter & Control, a company established by Rudnap Group in 2008 and run by Vojin Lazarevic. Vasiljevic said that,

*“every tender is a different story. There is room for manipulation. EPS should establish a Commission which can give out certificates for meters, so that the price is the only criterion, but they refuse to do it because their intended supplier will not win”.*⁸

Meter & Control rejects claims that it is favored by EPS, but many similar allegations have been made. Milovoje Stancic, director of another competing firm, Citi, argues

⁷ For more information, see <http://www.blic.rs/Vesti/Drustvo/519954/MULJAZA-Mnogo-je-lukav-Kako-je-Vulin-izigrao-zakon> and <http://www.transparentnost.org.rs/index.php/sr/aktivnosti-2/pod-lupom/7162-konkurs-u-ministarstvu-rada-krivicna-prijava-i-ostala-pitanja>

⁸ BIRN.

that the new technical specification for meters announced by EPS in April 2010 could, at the time, only be met by Meter & Control products. After this new specification was adopted, three companies, EPS, Electric Power Industry of Belgrade and Electric Power Industry Vojvodina Novi Sad, launched two tenders in 2011 for 43,000 meters to a total value of EUR 3.5 million. Both tenders were won by Meter & Control. The price of meters was 40% more expensive than the other products available locally. Branislav Vujanac, assistant to the director of Electric Power Industry Belgrade, stated that, “Meter&Control was winning tenders at the time because it was the only one company that could respond to the technical specifications”. However, Mirko Djuric, who ran the expert team in charge of developing EPS’s specifications, rejected claims that they were tailored to a specific supplier, arguing that 40 people had taken part in a transparent process to re-write the specification.

The tender also raised concerns about possible conflicts of interest related to the ‘revolving door’, whereby individuals move from jobs in the public-sector to positions with private-sector companies which bid for public contracts in the same field. Nikola Gasic, who took part in the development of the technical specification in 2010, later began to work for Rudnap group.

Within a year of the new specification being adopted, other suppliers adjusted their meters and became competitive again on the new terms. However, the tendering process still proved to be difficult. Of ten large tenders, five were later annulled on the grounds that the quality of meters had been evaluated by an unaccredited institution, the Mihajlo Pupin Institute, which was in a consortium with the Rudnap group. BIRN gained access to documents suggesting that EPS intentionally chose inadequate controllers. A document from a session attended by directors of all five Serbian Electric Power Industries held in Kladovo on 21 June 2011 stated:

“It is recommended that it should not be mentioned who does the preliminary evaluation, and the possibility of it being done by the Mihajlo Pupin Institute should not be excluded”.

This document was addressed to the General Director of EPS and signed by the Director of the EPS Directorate for Distribution, who later became the Deputy General Director.

Following the 2012 elections, the management team at EPS was replaced, and the new team once again modified the technical specification. Towards the end of 2012, EPS announced a tender for 30,000 meters to the value of 3 million euros. When the tender was published, a consortium led by Enel asked EPS to redress issues relating to 240 complaints. The process of addressing the complaints appears to have delayed the decision on the tender indefinitely. However, following the May 2014 floods, Electric Power Industry of Belgrade, on instructions from EPS, launched a new tender using emergency procedures. One of the directors of EPS, Zeljko Markovic, reached an agreement with suppliers to distribute 22,000 meters at the lowest price, i.e., 61 euros per unit. However, this agreement was subsequently dropped and Markovic transferred to a different position. A new tender was launched, which did not include a commitment to use the lowest price.

Monitoring institutions have played a role in policing these tenders. In two cases, the Republic Commission for the Protection of Rights in Public Procurement Procedures disputed tenders where the contracting authorities wished to conduct tenders according to emergency procedures. In both cases, the contracting authority had approached Meter & Control. In the EPS case, the Anti-Corruption Council concluded

that the conditions set by EPS were discriminatory and would prevent domestic producers from bidding both independently and in consortia.

However, in July 2014, Balkan Investigative Reporting Network (BIRN) reported that an Emirati company, Amplex, was set to manage a major project in Serbia to include the procurement of electricity meters. The contract was estimated to be worth 500 million euros, and Amplex was expected to acquire most of the electricity meters from local producers. However, since Amplex was given the project under a 2013 bilateral agreement between Serbia and the United Arab Emirates, it was not obliged to launch a tender for the procurement, but could instead decide independently from whom to purchase electricity meters and at what price. This large government purchase has, in this way, been removed from public scrutiny.

Case 4 Hydroelectric power stations

Our final case involves a tender let by the Ministry of Energy, Development and Environment, related to the construction of hydroelectric power stations.⁹ The tender was initiated in the context of Serbia's international commitment to obtain 27% of its electricity from renewable energy sources by 2020, up from 21%, as well as a 2009 decision to provide subsidies to renewable energy providers by granting them a 12-year period during which the government would purchase electricity from them at above-market prices.

⁹ The case was investigated by the Center for Investigative Reporting Serbia (CINS), a non-profit organization engaged in investigative journalism, with a particular focus on organized crime and corruption.

The first tender was announced in February 2013, resulting in the award of the right to build hydroelectric power stations to 90 investors in 212 locations. A second tender in December 2013 distributed 81 locations to 40 companies. The tender process exhibited a number of irregularities:

- The wording of the call aroused suspicion because it was very vague about what was expected of investors.
- A very short time period was to be granted to winning bidders to build the power stations – only two years, in which to collect all necessary permits and documentation, as well as complete the construction.
- Around 90 permits were required to build and operate a power station. The Ministry committed to reducing the number to 20 and to establishing a single office to coordinate the permitting process, but never delivered. In the meantime, many investors acquired one set of permits, only to have them expire before they could acquire the second set.¹⁰ For investors who failed to collect necessary permits in time, the Ministry unilaterally decided to withdraw their rights without informing them.
- The cadaster used for the tender, on which the possible locations of power stations were set out, was outdated, having been produced in the 1980s using military maps.

¹⁰ Information provided by experts interviewed for this project.

- Some of the locations were on land where the ownership was disputed, hence investors were given the right to build but could not agree prices with the locals.

These irregularities might reflect administrative error and lack of expertise. However, it later emerged that three of the winning bidders were owned by local municipality politicians from Raska, Surdulica and Ivanjica, who had not notified the Commission in advance of their conflicts of interest. According to the Anti-Corruption Agency Law, all companies owned by a public official are obliged to inform the Agency prior to engaging in a business arrangement involving the government. The local officials did not inform the Agency that they were taking part in the bidding nor that they owned companies which had won the rights to build power stations in the municipalities where they served.

In addition to awarding the contracts to companies where there was a conflict of interest, the Commission also let contracts to company owners and managers who were under criminal investigation. For example, Ozon Gradnja Company from Novi Sad was awarded five locations, despite being mentioned in an indictment from 2007 against the former Secretary of the Municipal Secretariat for Education and Culture, who is charged with letting contracts at inflated prices to generate illegal profit. The trial is ongoing. Additionally, five companies which won the right to 14 locations were based in off-shore locations - Cyprus, Lichtenstein or Switzerland. A number of procedural missteps and an overall lack of coordination also came to light.

CONCLUSIONS

Our evidence suggests that public procurement in Serbia is conducted in a particularistic and politicized context, which makes it vulnerable to corruption. There is considerable evidence that a large swathe of government contracting does not meet the standard of impartiality envisaged by the public procurement law. Rather, individuals engaged in administering procurement manipulate the procedures to write tenders that favour certain companies, sometimes companies which they themselves own. Although monitoring by formal institutions and civil society increasingly uncovers irregularities, there is a lack of political will to investigate them or to sanction contracting authorities and individuals that fail to comply with the rules. Monitoring institutions experience political pressure and their decisions are sometimes circumnavigated by high-ranking politicians.

While it is difficult to quantify the amount of funds that go astray or even to distinguish corruption from incompetence in many situations, the frequent occurrence of scandals and irregularities is likely to be detrimental to political and economic transition. In terms of democratization, such scandals undermine efforts to build state legitimacy, which would facilitate the broader process of state-building. In terms of the transition to a market economy, corruption scandals in procurement foster perceptions that tenders are manipulated and hence discourage companies from entering the market. More broadly, the difficulty of regulating public procurement effectively in societies where particularistic allocations of resources are the norm has implications for the trend towards outsourcing and new public management,

highlighting the need to invest adequate resources in empowering independent monitoring institutions.

References

- Batley R, McLoughlin C. 2010. Engagement with Non-State Service Providers in Fragile States: Reconciling State-Building and Service Delivery. *Development Policy Review* 28(2): 131-154.
- Blunt P, Turner M, Lindroth H. 2012. Patronage's Progress in Post-Soeharto Indonesia. *Public Administration and Development* 32(1): 64–81.
- Carothers T. 2010. Democracy Support and Development Aid: The Elusive Synthesis. *Journal of Democracy* 21(4): 12–26.
- Emek U, Acar M. 2015. Public Procurement in Infrastructure: The Case of Turkey. Chapter in Mungiu-Pippidi A (ed.) 2015 *Government Favouritism in Europe*, Barbara Budrich Publishers: Berlin.
- Fazekas M, Toth I, King L. 2013. Anatomy of Grand Corruption: A Composite Corruption Risk Index Based on Objective Data. CRC-WP/2013:02. Budapest: Corruption Research Center Budapest
- Fazekas M, Lukacs PA and Toth I. 2015. The Political Economy of Grand Corruption in Public Procurement in the Construction Sector of Hungary. Chapter in Mungiu-Pippidi A (ed.) 2015 *Government Favouritism in Europe*, Barbara Budrich Publishers: Berlin.
- Fukuyama F. 2004. *State-Building: Governance and World Order in the 21st Century*. Cornell University Press
- Ganev V. *Preying on the State: the transformation of Bulgaria after communism*, London: Cornell University Press, 2007.
- Grodeland A. 2006. Informality, corruption and public procurement in the Czech Republic, Slovenian, Bulgaria and Romania. In KICES Working Papers No. 6: 25-36, Koszalin:
- Grodeland A, Aasland A. 2011. Fighting corruption in public procurement in post-communist states: Obstacles and solutions. *Communist and Post-Communist Studies* 44: 17-32.
- Haider, A. 2010. Statebuilding and Peacebuilding in Situations of Conflict and Stability. Governance and Social Development Resource Centre, University of Birmingham.
- Handley-Schachler M, Gao SS. 2003. Can the private finance initiative be used in emerging economies? – lessons from the UK's successes and failures. *Managerial Finance* 29 (5/6): 36-51

Heggstad, K., M. Froystad and J. Isaksen (2010) The Basics of Integrity in Procurement, Version 3, Christian Michelsen Institute. <http://www.cmi.no/file/971>

Held D. 1996. *Models of Democracy*. Stanford University Press.

Hood C. 1991. A Public Management for All Seasons. *Public Administration* 69(1): 3-19.

Hood C, Dixon R. 2015. *A Government that Worked Better and Cost Less? Evaluating Three Decades of Reform and Change in UK Central Government*, Oxford: Oxford University Press.

Jing, Y. 2008. Outsourcing in China: An Exploratory Assessment. *Public Administration and Development* 28 (1): 119-128.

Jones DS. 2013. Procurement reform in the Philippines: The impact of elite capture and informal bureaucracy. *International Journal of Public Sector Management* 26 (5): 375–400.

Klitgaard R. 1988. *Controlling Corruption*. University of California Press: Berkeley.

Krastev I. 2005. *Corruption, anti-corruption sentiments, and the rule of law*. Central European University Press.

Leftwich A. 2000. *States of Development: On the Primacy of Politics in Development*. Cambridge: Polity Press.

Linz JJ, Stepan A, Gunther R. 1995. Democratic Transition and Consolidation in Southern Europe, with Reflections on Latin America and Eastern Europe. In *The Politics of Democratic Consolidation: Southern Europe in Comparative Perspective* (pp. 77–123).

Marquette H and Beswick D. 2011. Building Security and Development: State Building as a New Development Paradigm? *Third World Quarterly* 32(10): 1703-1714.

McLoughlin C. 2015. When does service delivery improve the legitimacy of a fragile or conflict-affected state? *Governance* 28(3): 341-356.

Mungiu-Pippidi A. 2005. Deconstructing Balkan particularism: the ambiguous social capital of Southeastern Europe. *Southeast European and Black Sea Studies*

Mungiu-Pippidi 2015. *The Quest for Good Governance: How Societies Develop Control of Corruption*. Cambridge University Press.

Mungiu-Pippidi A (ed.) 2015. *Government Favouritism in Europe: The ANTICORRP Project: Anticorruption Report vol. 3*.

Ndaruhutse S, Mansoor A, Chandran R, Cleaver F, Dolan J, Sondorp E and Vaux T. 2011. *State-Building, Peace-Building and Service Delivery in Fragile and Conflict-Affected States: Literature Review. Final Report*. CfBT Education Trust / Practical Action / Save the Children. <http://r4d.dfid.gov.uk/Output/191924/>

North D. 1990. *Institutions, Institutional Change and Economic Performance*, Cambridge University Press.

OECD. 2006. Bribery in Public Procurement. Methods, Actors and Counter-Measures. OECD, Paris.

OSCE. 2014. Public Procurement Corruption Map in the Republic of Serbia. Belgrade, 2014.

Podumljak M. and David-Barrett E. 2015. Political Favouritism in Croatian Public Procurement. Chapter in Mungiu-Pippidi A (ed.) 2015 *Government Favouritism in Europe*, Barbara Budrich Publishers: Berlin.

Rikalovic G, Knezevic B, Mikic H. Public Procurement System in Serbia in the Conditions of Global Economic Crisis. Paper for the international conference 'From Global Crisis to Economic Growth. Which Way to Take', Faculty of Economics of the University of Belgrade, 2012.

Rotberg RI. 2004. *When States Fail: Causes and Consequences*. Princeton University Press.

Rothstein B. 2011. *The Quality of Government: Corruption, Social Trust and Inequality in International Perspective*. University of Chicago Press: Chicago, Illinois.

Stefanov R, Karaboev S. 2015. The Bulgarian Public Procurement Market: Corruption Risks and Dynamics in the Construction Sector. Chapter in Mungiu-Pippidi A (ed.) 2015 *Government Favouritism in Europe*, Barbara Budrich Publishers: Berlin.

Transparency International. 2006. Handbook on Curbing Corruption in Public Procurement – Experiences from Indonesia, Malaysia and Pakistan

Transparency International Serbia. Capacity building in Public Procurement System in Serbia.

Wedel JR. 2004. Blurring the State-Private Divide: Flex Organisations and the Decline of Accountability, in Spoor M (ed.), *Globalisation, Poverty and Conflict*, Kluwer Academic Publishers: 217-235.