Exposing the foundations of corruption in construction

Neill Stansbury[1]

Surveys reveal corruption to be higher in construction than in any other sector of the economy.[2] The scale of corruption in construction is magnified by the size and scope of the sector, which ranges from transport infrastructure and power stations at the larger end to domestic housing at the smaller. It is a sector that includes projects initiated by both governments (often termed 'public works') and the private sector. Estimates of the total size of the global construction market are around US $3,200 billion per year. Its share of the economy varies from 5–7 per cent of GDP in developed and advanced developing countries, and around 2–3 per cent of GDP in lower-income developing countries.[3]

There is significant variation across the industry as to the nature and extent of corruption. Some sectors and territories are relatively free from corruption, and a significant number of organisations and individuals try to avoid corruption at all costs. The majority of contractors who do engage in corrupt practices tend to do so not because they want to, but because they feel they are forced to by the way the industry and the political environment operate.

Why is construction so prone to corruption?

Construction projects usually involve a large number of participants in a complex contractual structure. Figure 2.1 illustrates one possible (simplified) contractual structure for building a power station. Each line represents a contract between two actors (companies, governments, banks and so on).

In the construction of a power station, the 'client' (or owner) will normally be a government or a public corporation. At the project planning stage, the client contracts consultants and engineers (see top right of the figure) to carry out feasibility studies, environmental impact assessments and other planning exercises. The client will also raise project funds by negotiating agreements with commercial banks, development banks and international financial institutions (see top left of the figure). The client then awards the main construction contract to a single company (the 'main contractor') after carrying out a public tender according to the relevant regulations on public contracting.

The 'main contractor' is likely to be a private sector construction or engineering company, which may then subcontract key parts of the project according to its own guidelines for awarding contracts. Subcontractors may in turn sub-subcontract parts

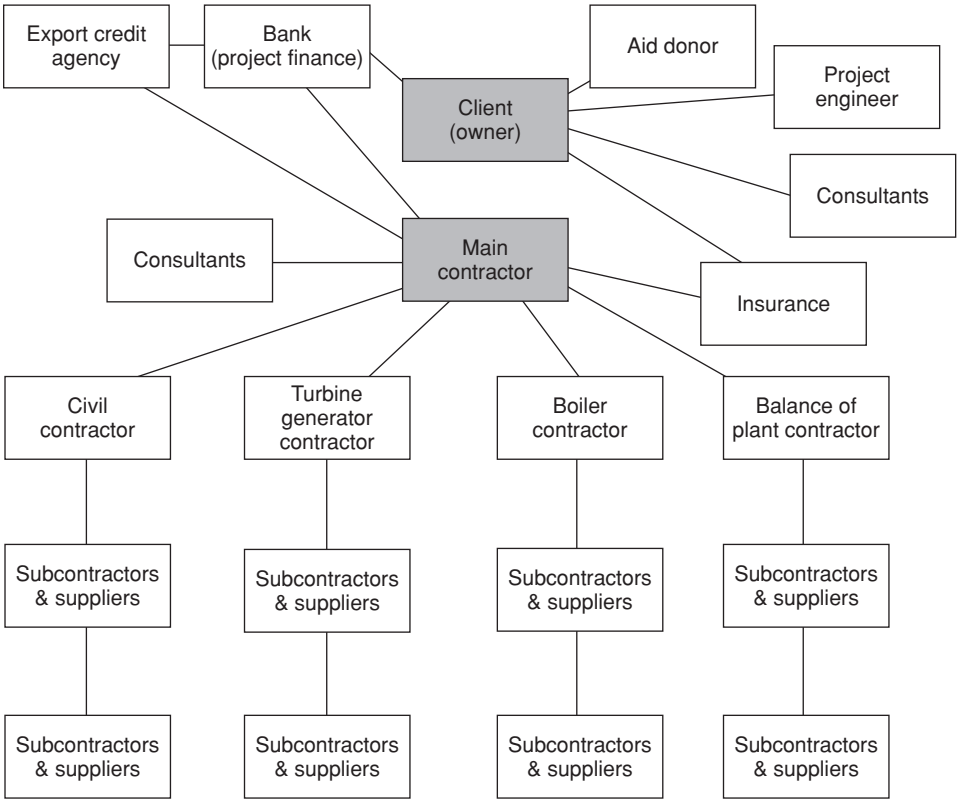

Figure 2.1: A simplified contractual structure for the construction of a power station

of their work, and sub-subcontractors may purchase equipment and materials from suppliers, or award further subcontracts.

The following features of construction projects make them particularly prone to corruption:

1. **Size of projects.** While construction projects vary in scale, infrastructure projects in particular are often huge. The costs of dams, power stations, industrial plants and highways can run into billions of dollars. It is easier to hide large bribes and inflated claims in large projects than it is in small projects.
2. **Uniqueness of projects.** The fact that many major construction projects are one-off makes costs difficult to compare, which in turn makes it easier to inflate costs or hide bribes.
3. **Government involvement.** Most infrastructure projects are government-owned. Even privatised projects require government approvals for planning or agreements to pay for end-product use. The industry tends to be heavily regulated at both national and local government level. Numerous permits are often required. Where there are insufficient controls on how government officials behave, their power

– combined with the structural and financial complexity of the projects – makes it relatively easy for officials to extract bribes.

4. **The number of contractual links.** While there are numerous variations to the project structure outlined above, the contractual cascade could easily have more than 1,000 links, each depending on other contractual links in the chain. Every single link provides an opportunity for someone to pay a bribe in exchange for the award of a contract. In addition, work and services are exchanged for payment in relation to every contractual link. Every item of work and every payment provide further opportunities for bribes to be paid in return either for certifying too much work, certifying defective work, certifying extensions of time or paying more expeditiously.
5. **The number of phases makes project oversight difficult.** Projects normally have several different phases, each involving different management teams and requiring handovers of the completed phase to the contractors undertaking the next phase. For example, a power station project may have the following phases: demand determination, choice of type (hydroelectric, coal, oil, gas), design, excavation, foundations, civil works, building works, equipment manufacture, equipment erection, commissioning and operation. Even if a single contractor undertakes all the project's phases, it will normally subcontract different elements of the task to individual subcontractors, which creates difficulties in control and oversight.
6. **The complexity of projects.** Because of project complexity, the interrelationship between contractors and events is often uncertain. People working together on a project frequently appear not to know, or to disagree upon, the reasons why something has gone wrong, or why costs overrun. This makes it easier to blame others and to claim payment, even when such claims are unjustified. Bribes and inflated claims can easily be hidden and blamed on other factors, such as poor design or mismanagement. Complexity also generates reasons to pay bribes since decisions on cause and effect and their cost consequences can have an enormous impact.
7. **Lack of frequency of projects.** Major projects come at irregular intervals. Winning these projects may be critical to the survival or profitability of contractors, which provides an incentive to contractors to bribe.
8. **Work is concealed.** Most components in construction end up being concealed by other components. Structural steel may be concealed by concrete, brickwork by plaster, engineering components in casings, and roof structures by cladding. The industry places an enormous dependence on the individuals who certify the correctness of the work done before it is concealed; once an item is concealed, it can be very costly or difficult to check if it was completed to the required standard. This cost and difficulty creates an incentive for contractors to do defective work or use inferior materials, and to bribe the relevant official to certify that the work was done according to specification.
9. **A culture of secrecy.** There is no culture of transparency in the construction industry. Costs are kept secret even when it is public money that is being spent. Commercial

confidentiality takes precedence over public interest. The routine inspection of books and records that might uncover malpractice does not normally occur.

10. **Entrenched national interests.** Local and national companies often have entrenched positions in their own market. These positions have often been cemented by bribery. International companies seeking to enter these markets may find it impossible to win work unless they pay a bribe.
11. **No single organisation governs the industry.** Construction brings together a wide range of professions, trades and specialist contractors, leading to varying standards of skill, integrity and oversight. The professions include architects, engineers, surveyors, accountants and lawyers; and the trades include machine operators, scaffolders, bricklayers, electricians and plumbers. Contractors' skills range from excavation to insulation, and from generators to cooling systems. Each profession or trade may have a different professional association, with different codes of conduct and levels of enforcement of these codes. No single organisation has overall responsibility.
12. **Lack of 'due diligence'.** The scale of funds involved in major infrastructure projects places great influence in the financing bodies that determine whether a project goes ahead, and which companies win the contracts. Commercial banks and global or regional development banks provide most of the funds, while government-sponsored export credit agencies may underwrite risky international projects. Their frequent lack of due diligence on participants in construction projects allows corruption to continue.
13. **The cost of integrity.** It is striking how many people working in the construction sector either accept the status quo, or make no attempt to change it. Bribery and deceptive practices are so engrained that they are often accepted as the norm. Bribery is frequently a routine business cost that many companies expect to include in the contract price. The fact that so many businesses in construction routinely pay bribes or engage in deception makes it very costly for any one company to act with integrity since that company would risk losing out to its less scrupulous competitors. As a result, many companies find themselves in a vicious circle in which they engage in corruption, often reluctantly, as a defensive measure against the corrupt practices of other companies. Fortunately, some businesses and industry associations are taking steps to change the status quo (see Box 2.1).

The mechanisms of corruption in construction[4]

Corrupt practices are found at every phase in construction projects: during planning and design, in the award of contracts, during the construction process, and during the operation and maintenance of projects after construction is finished.

Corruption in planning and design

During the planning and design stage, corruption can result in the initiation of projects that are overdesigned or overpriced. Corruption may result in the approval of projects that are unnecessary. In certain cases, projects are conceived solely as vehicles for

Box 2.1 A business perspective: promoting integrity in consulting engineering

Jorge Diaz Padilla[1]

Consulting engineering has evolved to become a major industry worldwide. The International Federation of Consulting Engineers (FIDIC)[2] estimates that this market represents almost US $500 billion in annual consulting fees, of which more than half is delivered by independent, private consulting companies. Clients are increasingly requiring assurance that consulting firms operate in a corruption-free environment, especially when it comes to government procurement.

Most consulting firms are doing their best to define and implement anti-corruption policies. Such approaches tend to be piecemeal, however. What is missing is an integrity baseline that can connect and transform isolated acts of integrity assurance into what FIDIC calls a complete Business Integrity Management System (BIMS), with formal procedures to identify potential risks, prevent and combat corruption, and implement business integrity policies for every project throughout the organisation. The 'Guidelines for Business Integrity Management in the Consulting Industry' and a FIDIC policy statement on integrity were issued in 2001, and the 'Business Integrity Management Training Manual' was published in 2002. Many companies have since developed and implemented a BIMS following the FIDIC guidelines, and some have obtained certification based on the ISO 9000 Standard.

The main steps for designing and implementing a BIMS are:

1. **Formulation of a code of conduct.** In order to ensure commitment, it is essential that the board of directors and senior management develop a code of conduct, which should be clear, simple, and easy to communicate and apply.
2. **Formulation of a business integrity policy.** The guideline requirements for an integrity policy are based mainly on the OECD Anti-Bribery Convention and FIDIC's code of ethics. The integrity policy hinges upon the fact that corruption is eliminated only by across-the-board honesty and integrity. Honesty is interpreted as freedom from fraud or deception, and integrity as the firm refusing to obtain or keep what does not fairly belong to it. The policy should be in keeping with all local rules and regulations as well as the company's code of conduct. The integrity policy must be documented, implemented, communicated internally and externally, and made publicly available.
3. **Appointment of a representative.** A senior member of the firm's management staff should be appointed as a representative to ensure that all the BIMS' requirements are met. A member of staff could also be selected to communicate between management and consultants.
4. **Identification of requirements for the BIMS.** The requirements should focus on the processes in a given firm that are vulnerable to corruption. The requirements might depend on: size and structure of the firm; the nature of its consulting services; local and national regulation and market forces; and the expectations and requirements of all the stakeholders.
5. **Analysis and evaluation of current practices.** An assessment should be made of how the firm currently deals with anti-corruption issues. The gap between current practices and the BIMS' requirements should be identified.
6. **Implementation tools for the BIMS.** A consulting firm should use the following tools to support the planning and implementation of its BIMS: a code of conduct; an

▶

integrity policy; definition of roles, responsibilities and authority; business integrity procedures for the main processes (proposal bidding and negotiation; project execution and delivery; project collection); accounting structure; enforcement measures; and a declaration of business integrity in the annual report. The firm must also establish a procedure to evaluate its sub-consultants and external advisers based on their own integrity policies, and keep records of their commitment to business integrity management.

7. **Documentation.** A BIMS must be well documented in order to provide evidence that all processes that may affect the business integrity of the services offered by the firm have been thoroughly anticipated. The extent of documentation is critical – over-documentation may reduce staff and management interest in using the procedure. The BIMS should be documented in a general Business Integrity Manual and, if required for significant projects, in a Project Integrity Records File.
8. **Analysis of current practices.** The BIMS must establish actions to be taken in case of failure to comply with the Business Integrity Policy. Appropriate actions in cases where corrupt practices are proven range from admonition to suspension or dismissal from the firm.

Once the BIMS is operating properly, and the consulting firm is confident that the guidelines are met, the firm should initiate an evaluation process to ensure continuous compliance. This process can involve: first-party evaluation, where the management and the staff representative evaluate the BIMS; second-party evaluation based on client feedback; or third-party evaluation, by an outside body. If an external evaluation is undertaken, it may be performed as part of an ISO 9001:2000 quality certification process.

In future, a new ISO standard could be developed to certify that a company has a functioning Business Integrity System. Such a standard need not be industry-specific; FIDIC's experience with integrity management could lead to an integrity standard for the construction industry as a whole, or even for other business sectors.

Notes

1. This article is based on the work developed by the FIDIC Integrity Management Task Force, chaired by Felipe Ochoa, and the Joint Working Group on Integrity, created under the auspices of FIDIC, with participation of the World Bank, the Inter-American Development Bank and the Pan American Federation of Consultants (FEPAC). Jorge Diaz Padilla is president-elect of FIDIC.
2. FIDIC, Fédération Internationale des Ingénieurs-Conseils, is the world's leading organisation representing the international consulting engineering industry. Founded in 1913, and with its headquarters in Geneva, it represents more than 30,000 firms in 70 countries.

corruption and would not have even passed the planning stage without that motivation. In others, a project might have been abandoned in the planning phase because of a critical environmental impact assessment, for example, had a bribe not been paid.

Most projects require approval, which is usually controlled by one or more public officials. Developers or contractors may pay bribes to obtain planning approval. The approval of public construction projects may also depend on the support of elected politicians at a national or local level. In such cases, opportunities exist for developers and contractors to buy support for their project by providing funds for politicians, their parties or the charitable causes that they favour.

Sometimes contractors may bribe the client's consulting engineer rather than the client's representative. A consulting engineer (which could be a major international firm) that undertakes the design for a client is in a powerful position since the engineer can design the project to favour a specific contractor's technology. In some instances, designing a contract in this way may be done in good faith in the belief that the relevant technology is best. In other cases, it may have been done in exchange for a bribe or the promise of future work.

Corruption in the award of contracts

Bribery

Bribery in relation to the award of contracts is the most visible form of corruption, particularly when contracts are for major works. This type of corruption normally involves the contractor paying a representative of the client a fee to secure the award of the contract. In some cases, the contractor bribes the consulting engineer who will advise the client that the briber's bid is the best. The payment, whether to client or consulting engineer, may be direct, though it is often made through intermediaries to obscure its identity and purpose.

- **Agents.** The most common form of intermediary is the agent. The contractor appoints an agent who has contacts with a representative of the client or with the government of the country concerned. The contractor pays the agent a percentage of the contract price on being awarded the contract. The agent passes part of the payment to the representative of the client or government in return for the contractor winning the contract. The payment is usually made in foreign currency into an offshore account. Contractors hide the bribes in formal agreements that state the scope of the agent's work. The scope of work will often be false or exaggerated, however, and the size of the payment significantly in excess of the value of any legitimate services the agent carries out.
- **Joint ventures and subsidiaries.** The level of due diligence by export credit agencies, banks and auditors is lower in some countries than others. When a contractor bids as part of an international joint venture from several countries, the joint venture may arrange for the agency agreement to be executed – and the commission paid – from the country least likely to discover the commission. Similarly, where the contractor is part of a multinational group, the commission may be paid by a subsidiary in a country where the commission is less likely to be detected. The subsidiary will then be repaid by the contractor through intercompany charges for false services or services of inflated value.
- **Subcontractors.** A contractor may also channel a bribe through a disguised subcontract arrangement. For example, a subcontractor might agree to provide equipment and materials to a contractor in return for a certain payment, but in reality it will not provide the services, or will provide services of a vastly lower value than the price agreed. The balance of the payment can then be passed on to the relevant party as a bribe.

In many cases, the contractor would prefer not to pay a bribe at all, but is informed by the client's representative or an agent that no contract will be awarded without one. This is sometimes referred to as extortion. On other occasions, the contractor initiates the payment. A contractor may approach the representative of the client or government and request the right to negotiate a contract on a non-competitive basis in return for a bribe. The absence of a competitive tender is likely both to raise the price and expand the scope of work.

A contractor may also initiate a bribe because it knows that its competitors in the bidding process are likely to offer bribes, so that it concludes that it has to pay the bribe to 'level the playing field'. However, one innovative tool developed by Transparency International – the Integrity Pact – overturns this logic by committing all bidders to refrain from bribery (see Box 2.2).

Box 2.2 Integrity Pact sheds light on Mexican electricity tender

Transparencia Mexicana

Developed by Transparency International, the Integrity Pact (IP) is aimed at preventing corruption in public procurement. It consists of an agreement between a government or government department and all bidders for a public sector contract. Under an IP, both sides agree not to pay, offer, demand or accept bribes, or collude with competitors to obtain the contract, or engage in such abuses while carrying it out. Bidders are asked to disclose all commissions and similar expenses paid by them to anybody connected to the contract. Sanctions apply when violations occur, ranging from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to blacklisting. Criminal, civil or disciplinary action may also be taken against employees of the government. The IP allows companies to refrain from bribing in the knowledge that their competitors are bound by the same rules. It allows governments to reduce the high cost of corruption in procurement, privatisation and licensing.

Transparencia Mexicana, TI's chapter in Mexico, had completed 15 IPs between 2001 and the time of writing, and had another 12 ongoing. The Mexican IP follows the same principles as the broader TI Integrity Pact, but has built in extra features that are intended to increase citizen participation in the contracting process. The main difference is that the Mexican IP introduces a so-called 'social witness' to oversee the process. The social witness is designated by Transparencia Mexicana and must be technically expert, independent, and enjoy a good reputation in the field. He or she must produce a final report that includes observations and recommendations about the process, a review of qualifying criteria for bidders, an assessment of the field of bidders and an evaluation of the rationale behind decisions taken by the contracting authority.

An example of the IP in practice is the 2002 bidding for a 1,228 GWh hydroelectricity plant, known as 'El Cajón', which was billed as Mexico's most important infrastructure project of the decade. This was the first time the federal government, via the Federal Electricity Commission (CFE), had accepted independent monitoring by a civil society organisation of a bidding process in the energy sector, which in Mexico has historically been perceived by the public to be tainted by high levels of corruption.

The IP lasted from August 2002 to June 2003. The first step in introducing the IP was to designate a social witness to monitor the process. The bidders were then required to

▶

submit Unilateral Integrity Declarations to Transparencia Mexicana as a condition for competing for the contract. These were signed by the highest-level officials of the bidding consortia. Declarations were also submitted by CFE officials and by all government officials involved directly in the contracting process. As part of the IP, Transparencia Mexicana met each of the bidders to ask them which parts of the process they considered might be most at risk of irregularities. Respondents said they were most worried about the fair evaluation of their proposals.

Thirty-one companies bought the guidelines for the contracting process. Of these, 21 did not submit proposals, and the remaining 10 split into three consortia that submitted proposals. These were evaluated on technical and economic grounds. The technical test was whether they complied with the qualifying criteria; the economic test was simply to determine the lowest bid. On the basis of the evaluation, the contract was offered to the consortium comprising Constructora Internacional de Infraestructura, Promotora e Inversora Adisa, Ingenieros Civiles Asociados, La Peninsular Compañía Constructora and Energomachexport-Power Machine. An offer of US $748 million was made for the contract, below the government's allocated budget for the project of US $812 million.

The complaints process

During the bidding process Transparencia Mexicana received one complaint by email about an alleged irregularity – that the CFE had provided confidential information to one of the bidders five months before the public tendering. Transparencia Mexicana requested a meeting with the complainant but did not receive a reply. Transparencia Mexicana also asked the CFE for an explanation. The CFE replied that it had posted information on the Internet about the 'El Cajón' project months ahead of the tender, requesting feedback about the project from interested parties.

None of the bidders filed complaints about the qualification criteria, nor the legal framework for the contracting process. At the time of writing, Transparencia Mexicana was not aware of any complaints that had not been resolved.

Next steps

Transparencia Mexicana's involvement in the 'El Cajón' contracting process represents a small opening of a door to a sector that has hitherto been closed to civil society and has been damaged by allegations of corruption.

The experience also serves to demonstrate some of the limitations of the IP, however. While an IP can help safeguard the contracting process against corruption, there is no guarantee that once underway the project will not be plagued by irregularities or unethical decision taking, potentially leading to massive cost overruns. The federal government should allow for civil society to go beyond the contracting process and oversee the execution of a public works project for compliance with the contract.

The tender process may be corrupted by international pressure. For example, the government of a developed country may influence the government of a developing country to make sure that a company from the developed country is awarded a project, even if it is not the cheapest or best option. Such pressure can take many forms, including the offer of aid, arms deals or agreements to support a government's application to join an international organisation. Great lengths are taken to conceal this pressure in some cases. In others, it is remarkably overt.

Although these examples relate mainly to major contract awards, the same principles apply all the way down the contractual chain. At the bottom end, a supplier may make a payment of US $100 to the procurement manager of a company in exchange for a minor supply contract. At the top end, the main contractor may pay US $50 million to the representative of a government in return for the award of a major infrastructure project.

Deception and collusion

Deception and collusion in the award of contracts takes many forms, typically involving a cartel:

- A group of contractors ostensibly in competition may secretly collude, agreeing to share future projects between them so as to keep prices high. They choose the winning bidder for a specific project and note the price to be submitted by the bidder they have agreed to pre-select. They all tender, but at prices higher than their favoured contractor, who the client then chooses as the cheapest option. The client is deceived into believing there was genuine competition in the bidding process.
- A group of contractors bidding for a project may secretly agree that each will include a pre-agreed sum in their tender that reflects the estimated aggregate bidding costs of all the tenderers. They do not pre-select the winning bidder, but tender in open competition. Whichever bidder is awarded the project then divides the pre-agreed sum between all the other tenderers as a 'loser's fee'.
- A group of suppliers of materials may collude to fix the minimum price of the materials they supply. Even when there is competitive tendering, prices will be kept higher than would be the case with genuine competition.

This form of collusion is often accompanied by bribery. For example, a bribe may be paid to a client's representative in order to obtain internal information on the expected budget, or to limit the number of bidders allowed.

Corruption during construction

Bribery

Bribery does not stop on the award of the contract. There are many actions after the award of a contract that can have a significant financial impact on the participants and which are therefore prone to bribery:

1. **Agreeing 'variations' to the contract.** It is rare for a contract to be completed in precisely the same form as originally agreed. Changes to the design or construction method may be required due to error in the original design, the intervening circumstances (such as unknown ground conditions), or the client's decision to change the requirements after the project is started. Changes to design or method are normally reflected in 'variations' (or 'change orders') to the contract. Variations

normally have cost consequences, as parts of the agreed work may be wasted, new items may have to be ordered, or additional labour and materials may be required. Variations therefore create opportunities for bribery between the contractor and the representative of the client, or the architect or engineer responsible for authorising the variation and approving its cost consequences. Major infrastructure projects can contain thousands of variations, ranging in cost from a few hundred to several million dollars. The cost effect is not only felt at the level of the main contract. Because of the complexity of the contractual structure in large construction projects, the effects and costs of variations need to be agreed between all affected participants, offering multiple opportunities for bribery.

2. **Concealing deferred bribes.** Variations provide a mechanism to conceal deferred bribes. A contractor may win a contract tender as the lowest-priced bidder without including a bribe in the contract price, but with a clandestine arrangement with the client's representative that a large variation including a bribe will be agreed at a later stage. Deferring a bribe until after the appointment of the contractor can be an effective means of concealment since there is no competitive tender for variations, and post-contract variations attract much less publicity than competitive tenders. The price of any variation (and of the bribe concealed within it) can therefore be extremely significant.
3. **Project delays.** It is very common for a project to finish later than scheduled whether due to adverse weather, variations, subcontractor failure or defective materials. The cost effect of delay can be significant. If the delay is the contractor's fault, the client may be entitled to claim liquidated damages from the contractor. If the delay is the client's fault, the contractor may be entitled to claim additional costs for delay and disruption from the client. As a result, the person responsible for agreeing the time and cost effect of delays is vulnerable to bribery. These ramifications may be felt all the way down the contractual structure, offering multiple opportunities for bribery.
4. **Concealing substandard work.** The quality of construction is central to a project. Since a large proportion of the work and materials is concealed as the project progresses, it can be difficult or costly to verify bad workmanship or inferior materials after the work has been covered. Therefore, checkers need to certify work as it progresses. These checkers are vulnerable to bribes to certify that defective or non-existent work is acceptable. The defects may not be discovered until many years later.

While some of the above examples depict the contractor bribing the architect or the client's representative, the converse is equally possible. The client may bribe the architect to certify falsely that the contractor delayed the project, with the result that the client is entitled to deduct liquidated damages from payments due to the contractor. The client may bribe the project engineer to certify falsely that the contractor's works are defective, entitling the client to withhold the contractor's retention payment.

The dispute resolution process is also not immune. Witnesses can be paid to give false evidence; experts can be paid for false 'independent' reports; and judges or arbitrators can be bribed to hand down favourable judgments. Construction disputes can be very complex: it may be difficult to prove that the opinions of witnesses, experts and judges have been unfairly influenced. Bribes to witnesses or experts may be cash, but they could equally involve the promise of future or continued employment.

Deception

Deceptive practices during project execution do not receive the same level of attention as bribes paid to win contracts, but deception is extremely common during this phase and may exceed the costs of bribery in terms of financial wastage. Deception involves actions that many people in construction regard not as corrupt, but as 'part of the game'. Deception can have an enormous impact on the overall contract price. It can occur at every contractual link and the cost of overcharges at the bottom end of the contractual ladder may be passed all the way up with a charge added at every rung, magnifying the cost of the initial deception. This is known as claims fraud or claims inflation.

- As noted earlier, variations can be made to the scope of contracts during execution and projects can be delayed. The cost consequences of variations and delays are sometimes resolved to the advantage of one contractual party through bribery, but a more common response is deceptive conduct. If the client issues a contractor with a variation order to change the scope of work, the contractor may take the opportunity to exaggerate the cost of the variation or the delay it causes. The contractor may also blame a delay that is the contractor's own fault on the client or the architect in a bid to avoid liquidated damages for delay, and to entitle the contractor to claim additional costs from the client.
- The client may also create artificial claims against the contractor. For example, a client may falsely allege that the contractor has delayed the project, or used inferior work or materials, in order to lay the foundations for an exaggerated or false claim to set off against sums due to the contractor. In doing so, the client knows the contractor can only receive payment by going to court or arbitration, which is expensive and time-consuming. The client may hope that the contractor will either give up the claim, or settle for a lesser payment than the amount actually due.
- An architect appointed by the client to work in the dual and conflicting roles of designer and certifier may avoid issuing a certificate entitling the contractor to additional cost or an extension of time, if the cause of that cost or time was a design error by the architect. This is deceptive conduct by the architect, who should exercise the function of certifier impartially.
- Deceptive practices by subcontractors and suppliers can also inflate project costs. A scaffolding firm may exaggerate the amount of scaffolding on site, or the number of men used to put it in place. An earth-works subcontractor may falsify the amount of earth removed.

- Lawyers and other professional advisers, whose livelihood depends on claims, can materially exacerbate the situation. They may allocate too many staff to work on a claim, charge for too many hours of work or give the client over-optimistic advice as to the likelihood of a claim's success.
- A contractor or client may enhance the deception by appointing an 'independent' expert to give testimony to support their case. An independent expert is meant to be impartial so as to help the dispute resolution tribunal come to a decision. If the expert gives an opinion which is not independent but slanted to one party's case, it may have a significant impact on the outcome of the hearing. Similarly, employees may give evidence that they know to be false in order to help their employer win a case.
- In many claims, a significant amount of false extra cost is added as a 'negotiation margin'. The claimant's logic in including this margin is that the opponent will automatically seek to reduce the claim and so a sufficient margin must be added to enable negotiations to arrive at the 'correct' figure.

Corruption during operation and maintenance

Once the project is completed, it will need to be operated and maintained. The operation of the project may require the supply of consumables such as fuel and raw materials. Roads need to be repaired and industrial plants need routine maintenance, repair and refurbishment.

As many opportunities for bribery and deception exist in this phase as during the contract award and construction phases. Bribes can be paid to win operation and maintenance contracts, and deceptive practices can lead to inflated costs. In many projects, the cost of operation and maintenance will exceed the actual capital cost of constructing the project. As a result, the opportunities for bribery may be greater.

Sometimes the same contractors that build the plant will also operate and maintain it, and so the bribe paid to win the main contract may also cover operation and maintenance. In some public/private projects, where a private consortium builds, owns and operates a project and then supplies the government or local utility with the end product, substantial opportunities exist for bribery in relation to agreeing the price that will be paid for the end product.

In high-technology projects, the contractor that built the project may be the only company capable of maintaining it. This gives it a monopoly of supply during the maintenance period, making cost comparisons difficult, and increasing the opportunities for concealing bribes and inflating claims.

In addition, high operating and maintenance costs may be a direct result of corruption during the contract award or construction phase. Corruption in the bidding process may be linked to the over-specification of a project, which may increase the costs of operation and maintenance. Corruption in the construction process may lower the standard of construction, increasing the subsequent need for expensive repair and maintenance.

Countering bribery

The construction sector is complex, diverse and fragmented, all of which contribute to a lack of effective control and the absence of uniform integrity standards. When combined with the complexity of the contractual structure, enormous opportunities are provided for corruption to flourish. The lack of transparency surrounding projects and the contentious environment both tend toward bribery and deception. The fact that bribery and deception are such common parts of industry practice leads many participants to accept them as the status quo, rather than attempt to change the way business is done. However, there are things that can be done – this report's recommendations (see page 65) set out concrete proposals for reform – and positive steps are being taken by some businesses to counter bribery in the sector (see Box 2.3).

Box 2.3 WEF task force adopts the Business Principles for Countering Bribery

Transparency International

At the World Economic Forum's (WEF) Annual Meeting at Davos, Switzerland, in January 2003, some leading engineering and construction companies formed the WEF Governors' Engineering and Construction Task Force in order to tackle corruption in the sector. The Task Force, working in close collaboration with Transparency International and the Basel Institute on Governance, met several times during 2003. As a result of agreements achieved at these meetings, 19 leading international companies from 15 countries with aggregate annual revenues in excess of US $70 billion signed the 'Business Principles for Countering Bribery in the Engineering and Construction Industry' at the WEF meeting at Davos in January 2004. This document was closely modelled on the 'Business Principles for Countering Bribery' developed in 2002 by Transparency International, in conjunction with Social Accountability International and several leading multinationals. An organisation which adopts the Business Principles commits:

- to adopt a policy that bribery in any form is prohibited;
- to implement a management programme which puts into effect its anti-bribery policy.

The Business Principles also provide practical guidance in relation to the scope and implementation of the anti-bribery programme.

Engineering and construction companies have traditionally been unwilling to take a public stand against corruption. The public announcement of the adoption of the Business Principles by these 19 companies broke with this tradition, and proves that key companies in the international industry believe that something can and must be done to deal with corruption. As Alan Boeckmann, chair and CEO of Fluor Corporation and head of the WEF Governors describes, 'nothing has been more frustrating than losing a great opportunity to a competitor who is willing to pay bribes'.

The Task Force continued to meet during 2004. These meetings focused on the following key issues:

- How to increase the number of international construction companies which adopt the Business Principles. In order to have any real effect on corruption, a significant

▶

majority of companies in the sector must commit to effective anti-corruption policies. Each member of the Task Force agreed to try to bring in additional signatories from its own territory or sector.

- How to ensure that companies that announce they have adopted the Business Principles are actually implementing a genuine anti-corruption programme. One of the ways of achieving this would be to obtain external accreditation of a company's anti-corruption programme. This idea is actively being pursued by the Task Force.
- How to ensure that companies that implement an effective anti-corruption programme are rewarded, and not penalised, for doing so. If some companies adopt an anti-corruption programme, and others do not, those that do not may continue to win work though bribery, therefore disadvantaging those that refuse to bribe. One way of ensuring that ethical companies are rewarded, is to request international financing institutions such as the World Bank, and public sector clients, to permit bids for projects only from companies that have adopted the Business Principles. In due course, once a system of external accreditation of the Business Principles has been established, only companies that have achieved the accreditation should be placed on bidders' lists. The Task Force has commenced discussions with the World Bank on this proposal and is greatly encouraged that the World Bank will in future require borrowers on large projects to certify that they will neither directly nor indirectly engage in bribery.

The next issue requiring urgent consideration by the Task Force is what inspection mechanisms should be put in place within projects to ensure that companies do not bribe. As with all voluntary codes, sceptics will question the credibility of subscribing companies' intentions. If bidders' lists require anti-bribery policies as a condition precedent, some companies may adopt them so as to reach the bidders' list, but will in practice continue to bribe. This could prejudice the companies that do adhere to the anti-bribery policy, and it is therefore in those companies' interests that proper inspection and enforcement mechanisms are put in place. TI has proposed to the Task Force the inspection and enforcement mechanisms referred to on pages 65–70.

Notes

1. Neill Stansbury is project director for construction & engineering at TI(UK). He is a lawyer specialising in the construction and engineering industry.
2. Transparency International's 2002 Bribe Payers Index (summarised in the *Global Corruption Report 2003*) reported that construction/public works are perceived to have the highest level of bribery of any sector, higher than both the arms industry and the oil and gas sector. Control Risks Group carried out a survey of business leaders in six developed countries (Britain, Germany, Hong Kong, Netherlands, Singapore and the United States), which also found construction/public works to be the most corrupt sector of all. See *Facing Up to Corruption* (London: Control Risks, 2002), summarised in the *Global Corruption Report 2004*.
3. UNCTAD, Regulation and Liberalization in the Construction Services Sector and its Contribution to the Development of Developing Countries (UNCTAD, 2000), available at www.unctad.org/en/docs/c1em12d2.en.pdf
4. TI defines 'corruption' as 'the abuse of entrusted power for private gain'. The expression 'corruption' in this article includes both bribery and deception.