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[Global Corruption Report 2007] Quantifying Public Procurement Losses in the Czech Republic

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21 Quantifying public procurement losses in the Czech Republic

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Corruption in public contracting is a major problem all over the world. Czech contracting processes are no exception and suffer from a serious lack of transparency and efficiency. Policy debate on public procurement often lacks the quantitative data needed to provide a correct assessment of the problem. TI Czech Republic (TIC) has attempted to provide such data by estimating losses caused by the inefficiency and lack of transparency in the awarding of public contracts in the country.

The methodology for arriving at this estimate was produced by TIC in cooperation with experts in public administration and economics from Prague University of Economics.² The data collection and research was undertaken between February and June 2005.

TIC used official data only, collected from the Ministry of Finance, the Czech Statistics Office and the independent Supreme Audit Office (SAO). The methodology was divided into an assessment of public procurement losses at the central government level and at the municipal level. According to the Public Procurement Act, procurement can take place by one of three methods: open, restricted competition or awarded without competition. The Act stipulates that a public tender must be held when the value of the contract exceeds CZK 2 million (US \$90,000).

Assessment of public procurement losses at the central government level

To evaluate the level of losses in central government contracting, the total amount of public funds used at the central level of public budgeting for the purchase of goods and services (public procurement) was determined, using data from the System of National Accounts (SNA) of the Czech Statistics Office. The SNA quantifies the maximum possible expenditure in the public contracting category at the central level. Based on the data, expenditure for the purchase of goods and services at the central level was calculated to be 4.3 per cent of GDP, or CZK 118.3 billion (US \$5.4 billion).

The average inefficiency rate occurring in the public sector was also assessed, by analysing data from the SAO's annual reports. During the past 12 years, the SAO has audited assets worth a total of nearly CZK 2,400 billion (US \$109 billion). Out of this, detected management deficiencies amounted to nearly CZK 350 billion (US \$16 billion), approximately 14.7 per cent, which is the figure we can use for inefficiency in public funds and property management. According to the SAO the term 'detected deficiencies' means direct as well as indirect state property losses;

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² All the materials used for the assessment of the losses and other related information are available on the TIC website, www.transparency.cz

public budget fund losses in general; defects in the conclusion of agreements; and incorrect, incomplete and non-evidentiary accounting. Such a wide definition is useful for our purpose because losses occur for the state not only due to lack of transparency in public procurement, but also due to incorrect evaluation and accounting and incorrectly written agreements.

The inefficiency rate of 14.7 per cent was then applied to expenditure for the purchase of goods and services by the public sector at the central level in 2004. The extent of inefficient management in this area of public funds expenditure was subsequently assessed. A rough estimate of financial expenditure related to public contracts due to various deficiencies can be made by a simple multiplication of the calculated inefficiency coefficient by the amount of funds that flow from the public sector mostly to the private sector in this way ($14.7\% \times 118.3$ billion = CZK 17.411 billion). In 2004, we estimate that out of the total amount of public funds, CZK 17.4 billion (US \$775 million) was used inefficiently at the central level.

Assessment of public procurement losses at the municipal level

Information concerning the provision of certain public services (collection of municipal waste, maintenance of roads, operation of water treatment plants, street lighting, cemeteries etc.) was obtained from more than 60 municipalities. The sample was selected so that it reflects the existing structure of municipalities in the country; municipalities located in non-standard conditions, such as mountain or spa resorts, were excluded. Data concerning the financial aspects of these services were obtained from the finance ministry website.

The calculations revealed that the costs per person of providing public services differ when a certain form of tendering procedure was used (open or restricted) as opposed to when the contract was awarded to a business company with majority municipal shareholding or when it was awarded directly, without competition. In the municipalities tested, the average price per person was 13.5 per cent higher when the contract was not tendered. Based on TIC research, 75 per cent of municipal expenses is paid through single-source procurement or to a municipal company. Applying these findings to all the municipalities in the Czech Republic, the average amount of economic losses is 12 per cent. If we accept certain simplifying assumptions, we can estimate the volume of economic losses, using simple extrapolation of the calculated coefficients to the size of the public procurement market, which is allocated by both above-mentioned methods: 12 per cent of the approximately CZK 171 billion (US \$ 8 billion) spent by municipalities on goods and services in 2004 gives us CZK 15 billion (US \$ 668 million) used inefficiently at the municipal level.

Adding losses at central and municipal levels gives a total of CZK 32.4 billion (US \$ 1.4 billion) in 2004.³

Conclusion

The research results were presented in June 2005 and widely reported in the national media. TIC followed up with meetings with the prime minister, government officials, MPs and other

³ Exchange rate in June 2005 was US \$1/23.1 CZK.

decision-makers to discuss proposals for reform of the national public procurement system and legislation.

Reactions to the published research results varied. Public sector representatives believed the numbers were too high; private companies frequently commented that losses might be even higher. There was no direct criticism of the research methodology, as TIC used official data.