

About the Causes of Corruption in the Hungarian Public Procurement System

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Abstract

According to practical experience and research, the functions of the Hungarian state – mainly the system of public procurement – are greatly involved in corruption

The aim of this study is to examine the social background regarding the corruption of public procurement after a brief historical overview, through investigating the overlapping phenomena and highlighting the importance of the legislation and the compulsory citizenship behavior which could easily be a subject to the abuse of cunning perpetrators.

The first factor that could explain the situation is the fact that in case of the Hungarian society the willingness to comply with the law is very low

The last factor that I would like to examine, which could be the first in the priority order and in my opinion goes hand in hand with corruption, is the operation of the Hungarian tender system.

Key-words: *corruption, system of public procurement.*

The Swiss State Secretariat for Economic Affairs defined corruption in 2009 as „the abuse of public power or position for private gain”.¹ Based on this definition and the Hungarian public procurement it can be said that the use of public funds is a section of the government operations where unfair advantage can be obtained directly, in a way that the decision-maker can transform the public funds at its disposal into private funds with very low risk. According to practical experience and research, the functions of the Hungarian state – mainly the system of public procurement – are greatly involved in corruption. This is also backed by the respective study of Transparency International Hungary and Corvinus University Budapest from 2009.² According to an opinion in the book: „the government sector is corrupt to the core even the major government procurements”. Table number 2 of the authors justifies this opinion: „Public procurement as a hotbed of corruption was the second most frequently mentioned issue by the interviewees.”³ Similar reports came from GKI (Hungarian Economic Research Institute) issued on November 3, 2009 regarding the research on corruption of public procurements, which was based on 120 deep interviews (buyers, bidders, official procurement advisors) and a sociological model of 900 person involved (buyers and bidders). Vértés András, president of GKI, summarized the research as such: „Corruption

¹ Hogyan előzzük meg a korrupciót? Szerk. Liliana de Sá Kirchknopf; SCO-Budapesti Corvinus Egyetem, Budapest 2009. 8. oldal

² Pálínkó-Szántó-Tóth: Üzleti korrupció Magyarországon. Korrupciós kockázatok az üzleti szektorban; Szerk. Szántó Zoltán – Tóth István János; TI-Corvinus 2009. 37. oldal

³ Pálínkó-Szántó-Tóth: im. 41. oldal

is a real issue in public procurements, and according to certain international organizations it is involved in 90% of the public procurement procedures, although this figure could be over-estimated. According to our research, the major part of the procedures is involved (although there is undue suspicion in certain cases) and approximately two-third or three-fourth of the domestic public procurements could be affected by corruption.”⁴

Not even the Council of the Public Procurement Authority disputes the aforementioned involvement in corruption. In their parliamentary report J/9457 of 2009 on the credibility, clarity and transparency of public procurements⁵ they frequently highlighted the influence of corruption on public procurements. Firstly, they proposed a research in 2007, which is yet to have any official results. Secondly, the report also highlights the fact, that observations made on corruption must be cautious: „the research obviously showed that bidders are usually far more aware and suspicious about possible corruption behind procurement procedures, than buyers”⁶. I would like to add that the attitude of buyers is not unexpected since their interest is to avert the suspicion of corruption. Várdy György, procurement officer, expressed his experience in a different way, stating that regarding procurement procedures 6 out of 10 are subject to some kind of problem. As a jurist working in this field I am hardly as optimistic, as I think that we could find a problem in case of 8 or 9 out of 10 procedures. Sometimes it would be enough to analyze the public procurement invitations, in which the subjectivity and intentions are impossible to be overlooked by the peer reviewers. I would like to add, that a characteristic of the current legislation is that the peers are legally responsible for the invitations according to the civil law⁷, however if the contracting authority places the invitation again without any correction then the Drafting Committee must publish the invitation that way.

The aim of this study is to examine the social background regarding the corruption of public procurement after a brief historical overview, through investigating the overlapping phenomena and highlighting the importance of the legislation and the compulsory citizenship behavior which could easily be a subject to the abuse of cunning perpetrators.

The public procurement system – similarly to taxation – already appeared in the organized societies of the classical antiquity (Greece, Rome) with legal institutions similar to current ones. In Greece, the emergence of the modern buyer-bidder positions (contracting authorities and tenderers), the determination and allocation of resources were linked especially to public constructions, acquisition of war material, and mining operations. An example was the regulation of the Athenian city-state that specified where and how the participants could purchase throughout the campaign. These issues were solved in most Greek city-states by preliminary talks and contracts that appeared

⁴ GKI: ez a korrupció melegágya; www.stop.hu/articles/article.php?id=562287 (2009. november 3.)

⁵ Beszámoló a Közbeszerzések Tanácsának a közbeszerzések tisztaságával és átláthatóságával kapcsolatos tapasztalatairól, valamint a 2008. január 1. - december 31. közötti időszakban végzett tevékenységéről (Budapest, 2009. július)

⁶ Közbeszerzések Tanácsa J/9457-es beszámoló 28-as oldal.

⁷ Erről részletesen lásd a közbeszerzési és tervpályázati hirdetmények megküldésének és közzétételének részletes szabályairól, a hirdetmények ellenőrzésének rendjéről és díjáról, valamint a Közbeszerzési Értesítőben történő közzététel rendjéről és díjáról szóló 34/2004. (III.12.) Korm. rendeletet.

to be the ancestor of the modern order-services interaction.⁸ A very mature system was developed regarding public construction projects that ensured the concept of public participation. The key role in the process was the so-called „*polétés*”, who used or leased the elements of state property, the public funds, via public procedures, often at public sales.⁹ Contracts concluded by the *polétés* are „reviewed by the Council, and should the Council determine any unlawful act related to the contracts, the *polétés* are subject to accusation by the public and handed over to the judge”.¹⁰ The *polétés* made public reports about the contracts that were published in People’s Assembly and were guarded by public slaves. From a modern perspective, this publicity reflected the concept of public interest. The details of the winner entry work were carved into marble in order to make the terms and conditions of the project public.

In ancient Rome, certain entrepreneurs were specialized in public procurements, however the transaction of major public investments were the task of the „censors”, who also specified serious tendering securities and guarantees regarding the proposals. The procurement orders could be acquired at public sales, and the evaluation of the tendering securities and guarantees of the winner bid was also the censors’ duty. As a result of the entrepreneurs’ bidding war, the tender with the lowest price won the order. Ancient authors like Cicero and Livius frequently reported on such occasions.¹¹ Acknowledging the work was a cornerstone of the contracts, and if the buyer was not satisfied with the quality of work performed, it could force the entrepreneur to correct and recondition the defects at its own expense. Certain elements of the current legislation are somewhat similar to the aforementioned practices, namely the collaterals. Even at that time, public constructions were subject to corruption.

In some cases the contractual parties invited to the public auctions were limited and predetermined. This happened „in the famous Castor-church case, when the buyer (Verres) – besides the limited publicity – had chosen the winner even before the auction, and later rejected the more favorable bidder.”¹²

From the long history of the Hungarian public procurement, I would like to highlight, that the purveyors to the Royal Court and the supplier channels had developed quite early, and at the end of the nineteenth century several sections of the Act XX of 1897 on public accounting determined the spending of public funds.

„The conclusion of contracts, or conventions by the state or the acceptance of proposals of such, as well as the establishment of legally valid and binding transcripts are all subject to public competition” (Section 38 of Act XX of 1897). Furthermore, Sections 39 and 40 added, that „the minister can ignore public competition to renew or extend expired contracts only in specific cases when public interest demands it, only with the permission of the minister council, and only if there were equally or more favorable options available”, as well as „Contracts concluded on behalf of the state regarding construction, sales, lease, equipment or acquisition, that values 5000 forints or more; it shall be reported to the directorate of the department of treasury, secretariat of legislative affairs in order to provide opinion on the terms and conditions of the contract, especially on the collaterals”. Detailed regulations before the socialist era regarding the supply of public procurements had been enacted from 1907, in which

⁸ Soós Adrienn: *Közbeszerzés Athénban és Rómában*; PhD Tanulmányok 7. PTE 2008. 336. oldal

⁹ Todd, S. C., *The Shape of Athenian Law*. (Oxford 1993.)

¹⁰ Arisztotelész: *Athéni állam XLVI. 2.*

¹¹ Idézi: Soós Adrienn, *im.* 329. oldal

¹² Soós Adrienn: *im.* 334-335. oldal

certain factors were taken into account such as the benefits and subsidies given to Hungarian suppliers, and participation in the First World War, disability and war cripples. Act 19 of 1987 on tendering that came into effect during the socialist era, that: „allowed international tendering only for a few, allowed the so-called restricted invitation to tender without any specific requirements, where the number of entrants was predetermined”¹³. Act XXXVIII of 1992 on the State Budget did not contain – until the new millennium – the rules of public procurement in full details, and therefore the act on tendering – still in force – was applied. Later, on November 1, 1995 the Act XL of 1995 came into effect that brought a significant advancement with its perspective, however the establishment of a well-functioning procurement system could not become a reality due to the lack of its traditions. The regulations in force complied with the requirements of the European Union only partially. It should be noted however, that this law stated from the very beginning, that in case of violation of the law „not only the offending party, but also the individual responsible for the infringement can be fined. Despite this, the Public Procurement Authority did not impose fine on natural persons.”¹⁴ Based on this study of Dessewffy Anna, it can be seen, that the number of legal remedies were low during the late 90s, while 45% of such proceedings were against local governments and their financial institutions, 28% of the legal proceedings were against central financial and budgetary institutions. „Only 22 legal proceedings were related to infringement regarding the call for bids, or the conditions of the documents”.¹⁵ The continuous criticism from both professionals and the public led to a completely new law, Act CXXIX of 2003 on public procurements that came into effect on May 1. Before I provide some thoughts on the aforementioned law, I would like to briefly analyze the sociological, legal, and political reasons behind the corruption in public procurement. 2000 billion forints were spent from the Hungarian State Budget on public procurements. Assuming, that we can eliminate the corruption premium – which is estimated at around 5-15% – then we could save up to hundreds of billions of forints for the state budget, that would make the continuous tax reforms, overtax, and the permanent state budget reforms unnecessary. This huge amount makes the certain links of corruption in public procurement worth analyzing at a social level. I would like to highlight some of these, as they could explain the strong influence of corruption on public procurement.

1. The first factor that could explain the situation is the fact that in case of the Hungarian society the willingness to comply with the law is very low. It can be observed in case of the enforcement of several legislations, that the compliance of Hungarian citizens with the legal norms is selective. Examples include the rules of the Highway Code, tax laws, the rules of civil law, and the norms of public procurement which are usually subject to the inaccurate use, misuse and misunderstanding by civilians, companies and sometimes even by state organizations.

Hungary is currently in an impaired condition that has negative consequences on public procurement as well. In this situation, managing public money should be of great importance. Those in the decision-making positions, who could access public funds or entitled to through their positions or connections, often aim at acquiring these public

¹³ Dessewffy Anna: A közbeszerzés és a korrupció összefüggései; Korrupció 2000. tanulmánykötet, 72. oldal

¹⁴ Dessewffy Anna: im. 77.

¹⁵ Dessewffy Anna: im. 76.

funds – what the American literature call, the „easy money” – through the accomplishment of public procurement procedures. The transformation of public funds into private money has become a part of our life, and although irrelevant to parties it generally characterizes the political life. Similarly to taxation, the decision-makers in public procurement positions can directly experience the conflicts between private and public interest, self-interest and social solidarity. A politician is just a man after all, and therefore can draw the line between social solidarity and the well-being of his or her own, as well as the well-being of its family, with hardly any social control. The decisions made regarding public procurement procedures are often the results of such selfish motivations. Since public money counts as easy money for some people, the lack of continuous and consistent control overshadows the social responsibility, which eventually loses against self-interest. I see the morally empty, atomized social environment as the reason for the widely acknowledged and accepted levels of corruption, as the society lacks interest in the fair and righteous use of public funds. An equally serious and important problem is the professional career built on the foundations of self-licensing, self-interest and performance, therefore the possibilities of unfolding the human skills in the politically influenced human resource system of the modern public administration. Some of today's decision-makers cannot or do not want to understand their responsibility in this process, and therefore cannot or do not want to take into account the public interest. Some of them socialized in a way, that human morality, the basic ethical, legal orders did not shape them as much in becoming a politician, while in case of others the process of becoming a professional politician made them insensitive. Only in such system could it happen that a politician convicted of tax evasion was delegated as member of an Eastern-Hungarian board responsible for the allocation of EU funds. I would like to highlight a domestic deterrent example about a young politician from Bács-Kiskun County, who has been in detention, with no qualification or professional background, yet he could actively participate in project management and the allocation of public funds, as well as establish deep and valuable connections. Normally this could be impossible in a well-functioning society.

As a counterexample I would like to add the case of Lónyai Menyhért, minister of finance during the era of dualism, who was accused of renting real property (land) with far too favorable terms, yet he did not rely on his parliamentary immunity, nor did he turn to the media to argue about the case. Instead, he resigned from his position and said: I am coming back to you, when the Hungarian Court declares my innocence. There has been no inherited steady and legal increase in wealth or cultural and ethical background behind the Hungarian people nowadays. As Percel Tamás psychologist stated: three generations of library are missing, that would ensure a safe family, property and intellectual background for all of us, and would provide the foundations of the ethical social behavior. This country has been severely plundered and has broken several times in the past 100 years. It not only lacks 150-year-old libraries, but the fundamentals as well. Imagine the mayor, who, at the age of 50, can finally conduct a billion-forint project. He has never been a well-paid employee throughout his career, and his living standards cannot be compared to his western counterparts. Therefore, what he sees in this procurement project is not public interest, but rather the golden opportunity of making money. The attitude of these individuals and politicians, as they aim to grab such golden opportunities may be understandable humanly, but as a jurist it is unacceptable.

2. The second factor that promotes corruption is the low standard of the legal-financial traditions. It is hardly arguable that the continuous reforms of the state budget

as well as the never-ending governmental reforms had discouraged professionals as well as civilians from getting acquainted with the laws a long time ago, and shook their confidence in legislation. As the way I see a reform is a positive process. We make progress from a negative position towards a more positive one. The people and the professional in Hungary have witnessed in the past 60 years, that we are living in the era of permanent reforms with continuously tightening our belts. They have learned that laws can quickly fade away, are not mandatory for everyone, and change so rapidly that it is not worth aligning with them. This is especially true for the tax laws and the rules of the public procurement law, which are essentially technical in nature. The current Act on Public Procurement is over 400 sections and includes more than 70 proceedings. This legislative text changed drastically since April 1, 2009, while several newer changes took place throughout this year. A significant part of the law is a mere adaptation of the European Union laws hence it completely lacks coherence. Consequent logical order, social security, public interest or ethical rules can hardly be identified in these norms. A series of practical research prove, that merely 4-5 out of 100 Hungarian civilians can name a public revenue, and from the deep interview-based research, that I conducted and involved 2500 people¹⁶, it can be seen that the majority agrees on the fact that tax evasion has no consequences in Hungary, and tax liabilities could be evaded through the right connections. It can be seen, that the Hungarian legal system is not consistent regarding either legislation or judgment. It is difficult to argue with Fricz Tamás, who states that this is „a country without consequences”. If we look at a few major public procurement procedures, that caused great debates, then we can ask the question what consequences the three unsuccessful port construction projects of Gönyű had, the continuous delay and cost increases of Metro 4, the fine of 10 billion forints imposed on the Csepel waste water treatment plant, or the significant delay of the European Cultural Capital project of Pécs. In my opinion those liable for these intentional or negligent acts will not be found or impeached, because no one aims at doing so. This attitude perfectly fits with the legal framework of the Hungarian public finance, where not just the public procurement problems have no consequences at all, but the legal institutions have become obsolete as well. I would like to add further examples, unrelated to public procurement, such as the failure in the detection of bleaching, the low number of final judgments regarding tax evasion proceedings (more people are convicted of homicide than tax evasion in Hungary), the cartels regarding highway constructions, and the position and management of offshore companies in the Hungarian legislation. The biggest problem is the lack of predictability and stability of the legal system. Legal compliance is impossible when something prohibited today becomes legal tomorrow, what can be done with impunity becomes punishable tomorrow, and all this happening in the pervaded and rampant web of the growing legislation. Let's imagine how the continuous and significant changes in the family support services or rental assistance and housing programs affect the Hungarian society and the population as a whole. To mention a current example for public procurement: since April 1, 2009 agricultural producers could receive millions or even billions of government subsidies without the restrictions to use the funds on public procurement projects. According to current rules, investments above the value of 1.3 billion forints, if the amount of subsidy is less than the own resources, then there is no need for public procurement procedure, while in

¹⁶ Ld. Bővebben: Dr. Szilovics Csaba Adózási ismeretek és adózói vélemények Magyarországon (2002-2007) 2009 Pécs

case of investments below the value of 1.3 billion forints there is no need to execute the public procurement procedure even if the subsidy amounts to 75%. This resulted in the fact, that agricultural companies waited till this term, and therefore they could use the subsidies to commission their friends to carry out the projects.

3. The third factor that I would like to analyze in this study is the role of politics. What I would like to highlight from the several problems of this system is that the Hungarian legislation does not use clear and sophisticated definitions, concepts, and morality. Nowadays politics cannot even decide whether our country is „poor or rich”. If we think ourselves rich, then we should know that no rich country can be founded on a poor society. Because this is an impoverished society, where hardly more than 50% of the working-age population are employed, where employees in the public sector have not received pay rise since 2002, where overconsumption is a continuously mentioned but false myth, and where besides the extremely low personal income levels, 80% of the taxpayers are subject to the highest tax rate of the Personal Income Tax (SZJA). If the political elite could admit the fact, that we are a poor country, then the public funds would be used wisely and would be spent in a fair and modest way. Therefore the appropriation of public funds, the continuous replacement of the vehicles, cell phones and furniture of the state budget institutions, the reputation-based foreign investments from public funds, the digital boards, the foreign military missions and the waived claims against the so-called developing countries must be stopped. We should think over the critical super-sized projects that never see the light of day, like EXPO, olimpia, the government quarter, water steps, since each and every forint spent on such investments is a loss. If we are a poor country, then we shall build a modest, but effective state. In this situation, the politicians should provide an example, that civilians could follow, pay their taxes, and so that they could sense the service-consideration balance at a macro level. Ordinary people can understand the message of politics regarding public money, they understand these processes, and they are ambivalent regarding the fact that the government tries to collect every single forint from them, economizes on public services, while the wasteful spending can be seen in other areas. In my opinion, the big overlap between the political and the economic (market) players is a huge problem. Even back in 900 B.C in Thèba was it prohibited for individuals to be a politician and then a business person within a short amount of time. Normally it could not happen that in a lawsuit between a private company and the state, a politically exposed person represents both the defendant, then later also represents the plaintiff. The level of government redistribution must be lowered radically. As a conclusion, I would like to mention the classic example of wasteful spending: the case of the digital blackboards, a public procurement which has cost 20-25 billion forints, while most of the schools have no central heating or even flush toilet, yet they could still have digital blackboards. Now, in November 2009, we know that the invitation to tender regarding the supply of digital school equipment has ended without results for the second time, because the only entrant that reached the second round returned an invalid tender. Further public tenders will not be issued.

4. The last factor that I would like to examine, which could be the first in the priority order and in my opinion goes hand in hand with corruption, is the operation of the Hungarian tender system. One of its main characteristics is that in most cases the winner could be predicted. The corruption often starts with the invitation to tender.

The first problem is that local governments cannot even finance the submission of the tender, the preparation of projects, and they do not even have the needed contributions. An important question is why the requesting parties insist on dealing with the same contractors that have caused damage during a previous project. The answer is the dependency that arises between the requesting party and the winning entrant, namely the project that binds them. The requesting party runs after its money, it wants to deliver the project on time however it forms a great relationship with the contractor, who in turn asks for a more flexible accounting that often includes allowance for additional work, or not enforcing the performance bond. Therefore they look for companies that have a performance related reward system and could settle the public procurement with its own contributions. One way to do this is to find a company that could be a potential winner with the required funds. That company then wants no more in return than to become the contractor for the project. This implicitly suggests the directional nature of public procurement, since the system can only be maintained if those who have to win will eventually win.

Naturally, the bidder knows this, and a wide range of experts have specialized in government projects, who work closely with one another and undertake all stages of the work, from tendering to conducting the project, in exchange for a considerable profit. Obviously, these groups could not maintain their activities without political support, and these experts are often related to political parties. Organizations aimed at acquiring public funds have emerged around each and every political party, similarly to the feudal system, mutually helping each other in realizing their goals at the disadvantage of the society. The fact that those win the procurement projects who eventually has to and may provide a return leads to the fact that demanding a quality service and enforcing claims and complaints becomes almost impossible due to the interwoven mutual interests. This results that public roads quickly deteriorate due to the low quality of constructions, trams are not equipped with air-conditioning, new buildings function inefficiently. In such cases in Hungary, instead of repairing the roads by the winning contractor at its own expense, a speed limit sign is placed at the critical distances due to the above mentioned problems. They don't redress the real problems, but instead they teach the civilians to accept the deteriorating conditions in such ways, that they not only set these speed limits at certain points but also enforce them, and the police can fine those who do not comply. Due to the current controlling mechanisms bidders can have a great advantage, because they can easily implement additional costs during the preparation of plans such as a 2-6% premium for the architectural plan and design, the architect's site supervision, and further 1-2% for the procurement, legal consultant, and quality assurance. However, the entrants can spend these amounts however they want and on whatever they want, as long as they keep it formal and legal. Since April 1, 2009 the legislature has facilitated their work, since official consulting on public procurement do not have to be reported if the respective costs are lower than 53-54 million forints. This consulting is often disguised as a legal service that involves the execution of the whole procurement procedure. In several cases, the invitation to tender specifies the implementation of a certain technology (certain ways of audio engineering or water treatment techniques for instance). Not to mention the fact, that the controlling and financing authorities often imply or implicitly suggest what architecture, supplier, and expert should be hired for the project. The threat of legal remedies and recourses, the preliminary control, and the possibility to cease funds can have a great pressure on the projects. A major flaw of the current public procurement procedures is that the

examination of the winning entrant regarding the quality of a potential procurement procedure is perfunctory. Although the State Audit Office does its best with the limited tools at its disposal, the public procurement procedures are not, or only formally and subsequently checked, and the disputes are resolved through legal remedies. The monitoring is usually subsequent and involves only the formal verification of the legal documentation. The Council of the Public Procurement Authority does not supervise the actual implementation, while the National Tax and Customs Administration is not capable of carrying this out, and the attitude of the financing authorities depend on the parties involved in the project. I would like to note, that nowadays in Hungary the delay or postponement of financing can kill any project. The respective monitoring of the European Union should not be overrated: this usually means the assignment of a law firm. The European Union reckons that the member states use these funds rationally and that everyone acts as one would expect. If the European Union finances Christmas projects, it does not take summer Santa Clauses into account that the projects would be carried out in the summer. This is unimaginable for them, and therefore they do not even deal with it. A major problem of the Hungarian public procurement system, that until the deadline expires, no delays in performance or default could be ascertained, and the party causing the delay could not be expelled. It could be mentioned as a positive change, that the amendments of April 1, 2009 ceased the preposterous situation with the so-called resource providing entities by restricting and limiting the possibility of acquiring funds.