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Combating Misuse of Public Funds in COVID-19 Emergency Procurement

The Covid-19 pandemic has revealed substantial shortcomings in central governments' and municipalities' ability to procure items needed in the fight against Covid-19, and corruption has been rampant partially due to the increased discretion of procurement staff to award contracts. We argue that suspension of ex ante rules safeguarding accountability is essential for disaster relief, but must be compensated for by better ex post monitoring. Such monitoring can be greatly strengthened by increasing transparency of all awarded contracts and providing incentives to whistleblowers to come forward to report fraud and corruption.

Corruption in Covid-19 procurement

The disastrous Covid-19 pandemic has revealed weaknesses in global supply chains and in national public procurement systems' ability to secure essential Personal Protective Equipment (PPE), ICU material, and Covid tests. Several countries have been and are experiencing issues like poor quality of procured goods, extremely high prices, scams, and a general inability to source.

Examples of quality under-provision abound. The Spanish government discovered that out of 340,000 tests purchased from a Chinese manufacturer, 60,000 of them did not test accurately for Covid-19 [1], and the Dutch ministry of health issued a recall of 600,000 face masks from a Chinese supplier due to poor quality [2]. Analogous problems were common in the UK [3, 4]. Several countries have also had difficulties to procure at all, for example in terms of their desired number of tests [5, 6], or the reagents used to analyze the tests [7], as well as swabs [8].

Reports on price gouging - selling at extremely high prices - are also widespread. Examples of price gouging and investigations by competition authorities can be found throughout Europe and the US, but also in developing countries like Indonesia, Brazil, Thailand, Kenya, and South Africa (OECD 2020a), and in Ecuador and Paraguay, with corruption as the alleged cause [9].

While many reasons lie behind these procurement failures, several of them are directly traceable to the abuse of the increased discretion granted by emergency procurement rules to urgently source material and bypass time-consuming public procurement processes and legal frameworks. This important and necessary increase in discretion can easily be abused to hand out contracts to friends and/or political allies or to cash bribes.

Again, examples in the press abound. In the UK, a clearly non-urgent contract was awarded without competition to a firm owned by two long term associates of Michael Gove and Dominic Cummings [10]. In Slovenia, a gambling mogul with no public record of healthcare experience appears to have received millions in an emergency contract related to Covid-19 [11]. In Bosnia, a raspberry farm was apparently granted a contract to import 100 ventilators, paying \$55,000 for each ventilator, while their price was around \$7,000 to \$30,000 on the international market in the relevant period [12]. In India, a Mumbai Realtor with no previous healthcare experience got a contract to supply things such as oxygen cylinder and medical beds [13]. The health minister in Bolivia was arrested in May after the country bought 179 ventilators at \$27,683 each while it later was revealed that the manufacturers were offering ventilators at approximately half that price [14]. In Bangladesh, Transparency International issued a study suggesting widespread corruption in the country during Covid-19, including the purchase of substandard medical supplies at five to ten times the market price [15].

The Covid-19 crisis has exacerbated an already significant problem: according to Transparency International (2020), up to 25% of all global healthcare procurement spending is lost to corruption.

Historically, fraud increases during emergencies

Disaster related fraud is frequently a problem in the western world as well. In September of 2005, in the aftermath of Hurricane Katrina in the US, the Hurricane Katrina Fraud Task Force was set up to go after frauds related to recovery funds. By August 30th, 2007, the task force had prosecuted 768 individuals for Katrina-related fraud, and additional state and local prosecutions for disaster-related fraud had been brought (DoJ 2007). The National Center for Disaster Fraud was also created within the justice department in the



aftermath of several devastating hurricanes in the US, and currently houses over 80 employees.

Organizations and academics warned the public early about the risk of increased corruption in public procurement during the Covid-19 pandemic (Khasiani et al 2020, OECD 2020b). Indeed, emergency procurement and disaster relief has historically been linked to increases in corruption (Leeson and Sobel, 2008), especially where institutions are weaker (Barone and Mocetti 2014). The problems often highlighted in this context, such as using emergency authority when it is not required/warranted or using it beyond the time it is required, abuse of discretionary authority, drawing up specifications to suit the firm desired to win the contract, restricting the number of bids, and caving in to political influences (Schultz and Søreide 2008: 523), have also been on display during the Covid-19 crisis.

There are of course compelling reasons to relax stringent procurement rules in emergencies to allow for a fast response proportional to the population's needs. But such a lessening of oversight and ex ante checks must be compensated for by much more extensive ex post checks, that should be advertised widely to deter public officials from abusing discretion. Broadly, there are two main ways of strengthening ex post checks/monitoring.

Two ways of ex post monitoring

The first is to have complete and transparent documentation of all the contracts awarded and the related documents, a "keep the receipt" mentality and practice, and making these records publicly available as soon as possible. Several countries have been moving in this direction as a response to the crisis, often with the help of NGOs like the Open Contracting Partnership (The Economist 2020). Examples include Ukraine, that require the submission of a report for each contract within a day of its conclusion, which is then made publicly available on an internet platform; and as

of 2016 a third of government contracts in Colombia were published on an e-procurement platform where they can then be scrutinized by the public. In the US, the user-friendly website USAspending.gov provide data on federal contracts, with advanced search functions including tags specific to Covid-19 contracting.

The organization Open Contracting Partnerships provide a list of suggestions for any government that is looking to increase transparency in procurement; it includes the timely publication of contracts, licenses, concessions, permits, grants, as well as related pre-studies and bid documents. A full list of best practices, which can be implemented at a low cost, can be found on their website (Open Contracting Partnerships 2020).

The second is to protect and incentivize whistleblowers. Adequate protection of whistleblowers is a first step, but protection is always partial and imperfect, and may therefore be insufficient to induce those close to frauds to come forward, given the terrible consequences they typically face (see e.g. Rothschild and Miethe 1999, Nyrreröd and Spagnolo 2020c).

In the U.S., the False Claims Act (FCA), first enacted by President Lincoln to curb fraud on military supplies during the civil war, and strengthened in 1986, has gone one step further by providing whistleblowers with substantial monetary rewards when they report on procurement fraud. Building on the success of the FCA, the US has introduced similar programs in several areas, most prominently with respect to tax evasion (in 2006) and securities fraud (in 2011).

Providing meaningful monetary incentives to whistleblowers who report on particularly egregious frauds and corruption can have a substantial deterrent effect on potential fraudsters as several studies show (see e.g. Wilde 2017, Johannesen and Stolper 2017, Wiedman and Zhu 2018, Amir et al. 2018, Leder-Lewis 2020; see Nyrreröd and Spagnolo 2020a for a review of the earlier literature). Simple cost-benefit analysis shows that a well-designed and implemented



whistleblower incentives scheme can be a highly cost-effective continuous monitoring tool for enforcement agencies and public prosecutors (see e.g. Nyrreröd and Spagnolo 2020b).

As for the EU, it is conspicuously lagging behind. Even prior to the Covid-19 crisis there was a need for increased monitoring evidenced by a 2019 European Court of Auditors (ECA) report entitled “Fighting fraud in EU spending: action needed.” A central emphasis of this report is that the Commission lacks insight into the scale, nature, causes, and level of fraud, as well as the level of undetected fraud. In 2018 the EU adopted a Directive that would harmonize and strengthen whistleblower protection in the EU. While the new EU Directive on whistleblowing is a step in the right direction, it failed to provide a framework for whistleblower rewards.

This may have been a mistake, as standard detection methods, including whistleblower protections, have often proven inadequate. The recent Wirecard scandal is a testament to the failure of standard fraud detection methods. In June of 2020, the stock price of Wirecard dropped from €100 to sub €2 in less than nine days after it was revealed to be an Enron-level accounting fraud. The firm has also allegedly laundered money for mobsters and was involved in a range of shady practices. Since 2008, fraud accusations have been leveled several times against the firm and Wirecard’s response was to label their critics “market manipulators”. The German financial supervisors, instead of investigating Wirecard, went after those who correctly claimed that the firm was a fraud, including reporters at the Financial Times. This fraud went undetected for at least 12 years, costing investors millions and undermining trust in financial markets. Moreover, those correctly accusing Wirecard of fraud allege they were subject to harassment campaigns, including phishing attacks by hackers and intimidating surveillance outside their homes and offices [16]. This is perhaps not surprising given that Germany is a country with some of the worst protections for whistleblower [17].

The shortcomings of traditional methods of fraud detection may turn out to be especially costly and ineffective during the Covid-19 pandemic.

Conclusions

With increased public spending being a cornerstone of the response to this crisis, adequate monitoring of abuse of public funds will become more urgent. Some EU institution, such as the European Public Prosecutor’s Office, or the European Anti-Fraud Office, could be suitable for a whistleblower reward program, as investigators are likely stuck looking for needles in haystacks, or lack the necessary information to bring/recommend actions to recover funds. Irrespective of the lost opportunity of the Directive, evidence shows it is time to introduce serious (high stakes) whistleblower rewards programs in Europe, unless of course Europeans are not able to manage them, or are more interested in hiding rather than airing their dirty laundry.

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