

LAD CASE STUDY

ProZorro – From a Volunteer Initiative to a Major State Reform

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ABOUT LAD

The Leadership Academy for Development (LAD) trains government officials and business leaders from developing countries to help the private sector be a constructive force for economic growth and development. It teaches carefully selected participants how to be effective reform leaders, promoting sound public policies in complex and contentious settings. LAD is a project of the Center on Democracy, Development and the Rule of Law, part of Stanford University's Freeman Spogli Institute for International Studies, and is conducted in partnership with the Johns Hopkins School of Advanced International Studies.

ProZorro in Ukraine – From a Volunteer Initiative to a Major State Reform

A transparent and robust government procurement process is a requirement for sustained economic development. This case explores the difficulties civil society advocates and government officials faced in reforming the notoriously corrupt process by which the Ukraine government purchased a wide variety of goods and services. The decisions these reformers confronted involved questions of system design, timing, implementation strategy and the role of civil society members throughout the process.

In March 2014, soon after the Maidan revolution began, a team of volunteer civil society advocates and experts began working on the design of a new and more robust procurement system for Ukraine, a reform key to Ukraine's anticorruption policy and economic growth. However, by August 2014, the reformers faced a fundamental strategic dilemma: Their political champion within the Ukrainian state, Pavlo Sheremeta, the minister for economic development and trade, unexpectedly resigned, in protest over the policies of the prime minister. Should the reformers press ahead without that key government backer and despite uncertain support from other top officials? Or should they wait for a more propitious set of political circumstances? Their choice raises important questions involving the advantages and risks of pushing change from the ground up versus a more traditional approach of first enlisting support from leaders inside the government who have the political authority to impose reform.

Introduction: Ukraine's Politics and Economy

Following the breakup of the Soviet Union, Ukraine endured years of corruption, mismanagement, stagnant economic growth, and currency devaluation. Successive Ukrainian governments in the 2000s sought a closer relationship with the European Union (EU) and access to western capital markets. President Victor Yanukovich announced his intention to sign an agreement that would move in this direction, while taking steps to liberalize the country in return. But in late 2013, he abruptly abandoned course, sparking a wave of protests known as the "Euromaidan" movement. During this ongoing uprising in Kiev's central square, Yanukovich instead signed a treaty and accepted a multibillion-dollar loan from Russia. Ukrainian security forces cracked down on the protesters, further inflaming the situation and resulting in a series of violent street clashes that ultimately prompted Yanukovich to flee to Russia.

The resulting political turmoil came after decades of corruption and poor planning that had eroded the nation's economic fundamentals.

In Soviet times, the economy of Ukraine was the second largest in the Soviet Union. After gaining its independence, the country made slow progress toward structural reform. A legal framework for privatization and economic modernization was developed, but resistance to reform was widespread within the government, and by 2012, about half of Ukraine's enterprises (including utilities) were legally exempted from the existing public procurement process, flawed though it was. Moreover, when surveyed, most Ukrainian citizens, who still have high expectations of the government's ability to provide services, said they had little to no trust in their government.

As a result, although Ukraine remains among the top five world exporters of grain and a major exporter of metallurgy industry products, military goods and equipment, the nation ranked as one of the most plagued by crony capitalism by *The Economist* in 2014. It ranked just as low on the Ease of Doing Business Index (96th), and low on Transparency International's 2015 Corruption Perception Index (130th).

Corruption has contributed to the nation's high tax rate (54.9% according to World Bank data), low living standards and to some jarring economic contrasts: Although average monthly wages had dropped to USD 175 (UAH 4,362) by January 2016 (Appendix 1), a few wealthy Ukrainians nonetheless drive cars worth over USD 200,000.

Emigration and dropping birth rates constitute a public referendum of sorts on a nation's future. In Ukraine, both factors have caused the nation's population to drop from 52.2M in 1993 to 42.6M in October 2016, a loss of about 10M people.

Despite these problems as well as direct Russian aggression, Ukraine has made progress in the three years since the 2013-2014 Revolution. The nation enacted new anti-corruption legislation including the creation of new independent bodies (the Anti-Corruption Bureau and the National Agency for Prevention of Corruption), deregulated some economic activities, reformed the nation's banking system, the police, the military and the judicial system, and moved toward energy independence and EU-recognized reform in the energy sector.

The Sorry State of Public Procurement in Ukraine

During the Yanukovich presidency, corrupt public procurement practices were formalized in law. Between 2010 and 2013, the Law of Ukraine on Public Procurement was amended 35 times, distorting and undermining competition as well as the transparency of the process and multiplying inefficiencies. For

instance, the law exempted 43 different types of key goods and services from any competitive process. Some of these exemptions are appropriate; for example, the government should not prioritize cost in the procurement of nuclear weapons technology. The same rationale, however, does not apply to other exemptions, such as buying food for circus animals or supplies for outdoor events.

The European football championship (EURO 2012), which Ukraine and Poland jointly hosted, is a particularly egregious example. Contracts for the Ukrainian portion of EURO 2012 were awarded without any competition, allegedly because of time constraints. The Agency for the Preparation of the Cup, established for the games, was authorized to conduct procurements outside of the existing law using a “simplified procedure,” which meant not soliciting competitive bids or imposing any controls on fees for service, the price of goods and public works or the selection of bidders. Thus, the final minutes of the meeting of the Commission for Approving Procurement Procedures with one bidder were dated 24.07.2012, the date the tournament ended. Further investigation by the Antimonopoly Committee of Ukraine found that the majority of the procedures approved by that agency had no reasonable justification.

As the volume of public procurement grew nationally (from UAH 167B/USD 20B in 2008 to UAH 250B/USD30B), corruption drained an estimated USD 5-6B from the national economy (Appendix 2). Moreover, the taint of corruption metastasized from government contracting to infect the Ukrainian police, judges and other public officials.

Revolution and the Opening for Reform

In the view of many Ukrainians, once Viktor Yanukovich and his associates concentrated power, they literally enshrined corruption in the law. The Revolution of Dignity (Euromaidan), which lasted from November 21, 2013 until February 22, 2014 and drew hundreds of thousands of protesters, was in part a reaction to these actions. Once the government fell and Yanukovich fled the country, the resulting power vacuum, together with years of mismanagement triggered high inflation and provided the pretext for the Russian annexation of the Crimean Peninsula and invasion of Eastern Ukraine.

This turmoil also opened a window for reform, enticing a group of Maidan activists to leave their private sector posts to create change within the government. One was Pavlo Sheremeta, ex-dean of Kyiv-Mohyla Business School and the president of the Kyiv School of Economics. In late February 2014, after the Revolution of Dignity, he was appointed the minister for economic development and trade (MEDT) and identified reform of the public procurement process as one of his priorities. A group of volunteers resolved to help the new minister to design and implement the needed changes. Since the vast majority of these

volunteers were from the private sector, they had no previous experience in the field or with formulating government policy.

The first step was to help Sheremeta change the special law ‘On Government Procurement’ that contained 43 exceptions and many corrupt provisions. The team worked for over a month together with the EU and Ukrainian experts, as well as MEDT employees. One early task was to identify which exemptions to retain in the law and which to eliminate. Even though the new law was substantially different from the previous one and aimed to comply with the best international standards, the reformers realized it was not a “breakthrough reform.” It had to be something significantly larger and pivotal, since merely introducing changes to this law would not change the level of trust toward procurements at large.

An informal working group soon came together to draft wholesale procurement reform. The government workers who had overseen government contracting in the past were poorly paid and often seen as “rent-seekers,” reinforcing corrupt practices. Those who alleged corruption found recourse to a fair appeal process impossible and some businesses found themselves subject to “special inspections” by controlling authorities that were triggered by disgruntled competitors. Winning contractors often experienced significant delays in receiving payment for goods and services, although bribes to government procurement officers could speed payment. As a result, suppliers were under increasing pressure to participate in this quid-pro-quo system.

The reform team began by studying procurement practices elsewhere, focusing especially on the experiences of post-Soviet countries with a similar heritage of corruption and low public trust toward institutions. They quickly realized that a comprehensive electronic procurement system for all tenders could significantly improve both access to and the integrity of public contracting, as well as improve the transparency of procurements. After a long round of discussions, the group decided to work towards digitization. The volunteers believed that implementation of an e-procurement system would streamline and improve public procurements:

- A public buyer would be able to easily announce and conduct a tender;
- The bidding process for prospective bidders would be simple, transparent and fair;
- Anyone would be able to easily compare the results of the tender, further ensuring a fair and transparent process.

There was no single best-practice model available that seemed most appropriate for Ukraine, and the complexity and diversity of the procurement process meant that there was no consensus among Ukrainian experts on the direction for reform. Yet the reformers were particularly impressed by the system adopted in

Georgia, another post-Soviet state, during 2009 and 2010 to address problems similar to those plaguing the Ukrainian procurement system. Moreover, experience in other countries indicated that an electronic procurement system could produce savings of more than 10% per year over more traditional paper systems. Those savings might even be higher in Ukraine since electronic procurement promised to eliminate its systemic corruption and simplify access for businesses.

Based on the positive experience in other countries, adoption of an electronic system was first suggested in June 2014 and presented to newly elected President Petro Poroshenko. To activate the reform, Pavlo Sheremeta established a working group within the MEDT, which included some of the Ukrainian activists, as well as Georgians who had implemented their own e-procurement reform. Another group was working with the dedicated committee of the Parliament to draft a new bill launching the electronic system. The team of volunteers acted as a bridge, coordinating between these two powerful groups of stakeholders, which now worked in parallel.

By early August 2014, the task force had formally recommended adoption of an e-system “mono platform,”¹ which the state alone would control, and a draft e-procurement law was submitted to the Parliament. Some international donors supported this approach and were prepared to help fund the design and implementation of a system similar to that successfully adopted in Georgia.

However, the political ground shifted dramatically in mid-August when Minister Sheremeta unexpectedly resigned in protest of Prime Minister Arseniy Yatseniuk’s decision to appoint as deputy minister of economy an individual with a reputation for corruption. Sheremeta was dismayed both by the nomination and his inability to choose his own staff. At the same time, a new election for Parliament was announced, leaving the draft law that had been submitted to Parliament in limbo. Without legal power to implement changes or support from the international community to implement their procurement plan, the volunteers were unsure of their next steps.

There were three potential scenarios. The team’s preferred approach was modeled after reforms successfully implemented in Georgia. Because the Georgian government played a crucial role in that process, one option for activists was to suspend e-procurement implementation efforts and instead focus on areas of reform with continuing political support from government leaders. Public procurement had been a priority for Pavlo Sheremeta, but the new minister would likely have other priorities. It would be too risky to develop a huge IT-system for the whole country without any buy-in from the government. The chances that it could work in

¹ There are two major models for organizing electronic government services: For mono-platform services, the government controls both the user-facing website and the back office. A second approach is for the government to handle the back-office operations but a private vendor handles the user interfaces.

the future at all were truly elusive. Moreover, no one from the activist group planned on becoming a part of the government in the near future. This movement was still seen as a volunteer initiative. The key reason for their unwillingness to move into the government was a low level of trust that was exacerbated by corruption, excessive bureaucracy, non-transparent decision-making processes, and extremely low pay (Appendix 3).

The second option was to suspend the process for approximately six months until a new minister is selected and installed. In the meantime, the team could prepare for eventual implementation by drafting necessary legislation, securing donor funding, and drafting a blueprint for implementation for an e-procurement system when there is institutional capacity to support this reform. Such a clearly defined roadmap for implementation would increase chances for international support and technical assistance, necessary for development of the IT product. While this approach had wide support because all the parties or stakeholders could understand its value, it required government leadership in the initial phase. Widespread distrust of the government could also undermine progress, causing delays in the development of this complex IT project and jeopardizing its ultimate success. As a result, even those stakeholders who initially supported development of an e-procurement system might fall away. Nevertheless, this approach had the most support, since top-down reforms are usually the gold standard for long-term development and sustainability. In this scenario, activists would assist with general coordination and support civil servants, and would continue to advocate for the procurement reform once a new government was elected.

The third scenario emerged from one of the countless round-tables sponsored by Dmytro Shymkiv, deputy head of the presidential administration and ex-director of Microsoft Ukraine. During the political vacuum, activists could develop and test the software for an e-procurement system on so-called ‘below-the-threshold’ procedures – procurement(s) for small amounts,² which were not regulated by the law and left to buyers’ discretion. Since the main law, “On Government Procurement,” did not directly regulate these procedures, each contracting authority could implement their own e-procurement mechanisms. However, as government entities are usually prohibited from executing anything directly envisaged in the law, it might be hard to find volunteers from the government to push for the reform during this period.

Additionally, Dmytro suggested involving private commercial marketplaces or vendors that already provided e-procurement services for Ukraine’s commercial sector. Such a step would help develop financial backing for the ultimate e-procurement system, as donors refused to deal with activists without any commitment from

² In Ukraine, below-the-threshold procurement applies to contracts valued at USD 8000 or less. The thresholds are higher in other countries.

the state and the system's source of funding was yet to be determined. Moreover, the EU Delegation, which has a project dedicated to public procurement capacity building and was the most active on the donors' side, was somewhat opposed to the whole idea of e-procurement, suggesting the reforms instead focus on professionalizing the agency's current staff. Still, private sector financing of the IT system was risky, since it could bias the resulting system towards their interests and privilege particular vendors. These marketplaces could also change their mind at any moment if they did not agree with the government's policy. The level of expertise could also suffer, since the group of activists could only count on experts who were willing to work pro bono. Consequently, there was a need for an official institution to host the system.

However, if the system's pilot went well, the future minister might be more inclined to adopt it especially since such an option would not require any changes to the law and could significantly save time for its kick off.

In sum, there were three potential scenarios to advance progress toward public procurement reform:

- Suspend activities until the newly appointed minister is on board and articulates his/her political agenda. Proceed if that agenda contains public procurement reform;
- Choosing to work with a top-down approach that focuses on preparing the necessary legislative basis and a clear roadmap for implementation, ultimately leaving reforms up to the newly appointed minister;
- Choosing a "bottom-up" approach that entails a group of activists taking the lead on developing an e-procurement system for below-the-threshold purchases, with voluntary support from contracting authorities, commercial platforms and experts.

Each scenario has advantages and disadvantages. What should the group of activists do?

Appendices

APPENDIX 1. Corruption Perception Index in Ukraine

Year	Ranking	Corruption Perception Index Score		Confidence Range ^[105]	Standard Deviation
		0-10	0-100		
2004	122 of 146	2.2		2.0–2.4	
2005	107 of 158	2.6		2.4–2.8	
2006	99 of 163	2.8		2.5–3.0	
2007	118 of 179	2.7		2.4–3.0	
2008	134 of 180	2.5		2.0–2.8	
2009	146 of 180	2.2		2.0–2.6	
2010	134 of 178	2.4		2.1–2.6	
2011	152 of 183	2.3		2.1–2.5	
2012	144 of 176		26	24–29	5.46
2013	144 of 175		25	22–28	
2014	142 of 175		26	23–29	
2015	130 of 167		27	24–30	

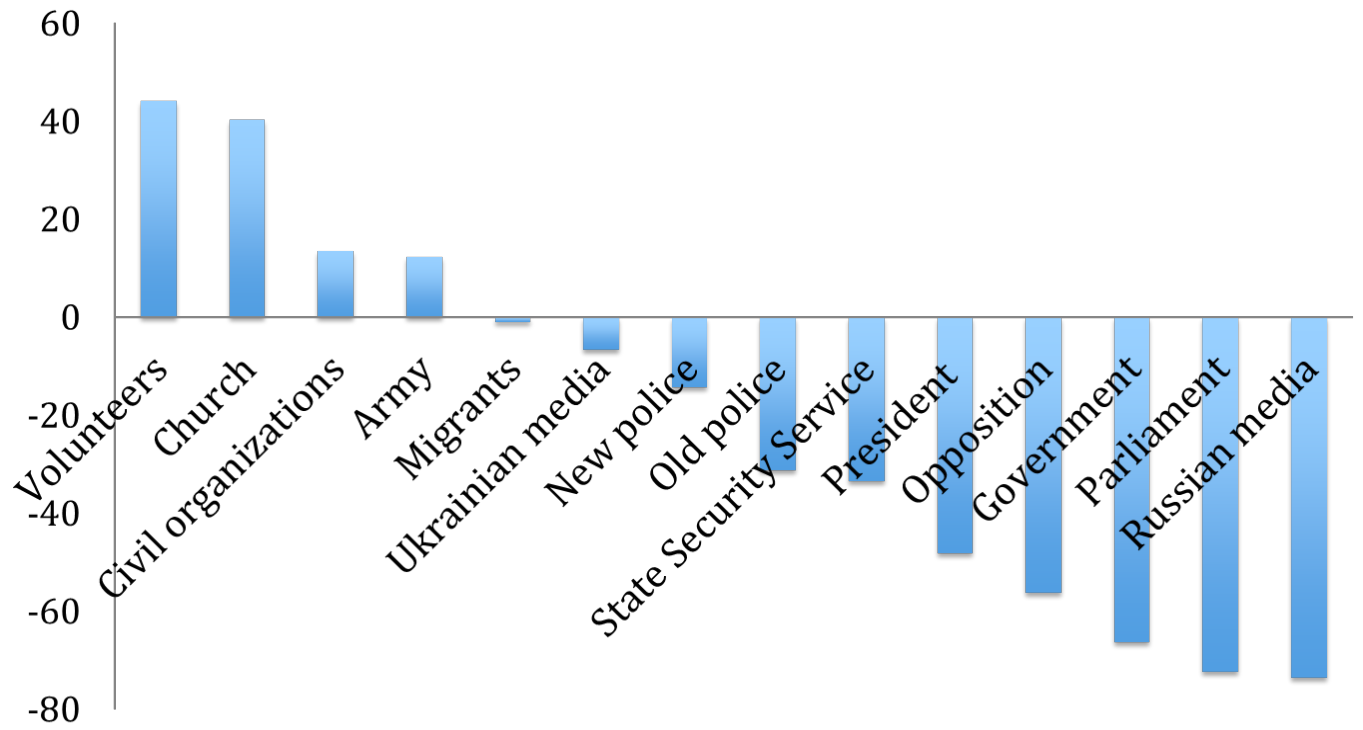
Source: <https://www.transparency.org/country/UKR>, <http://www.transparency.org/cpi2015>

APPENDIX 2. Statistics for Public Procurements in Ukraine

	Above-Threshold Procedures		Below-Threshold Procedures		
Year	Number, pc	Cost, UAH M	Number, pc	Cost, UAH M	Total amount, UAH M
2008	66,482	167,297.6	9,528	80,319.1	247,616.7
2009	50,396	105,268.3	2,752	29,972.2	135,240.5
2010	55,337	172,121.9	1,593,171	181,428.7	353,550.6
2011	79,139	325,101.5	1,905,020	158,339.1	483,440.6
2012	103,352	428,063.5	2,065,944	194,482.0	622,545.5
2013	76,774	185,467.6	1,836,047	95,277.6	280,745.2
2014	64,257	113,791.5	1,498,535	133,460.1	247,251.6
2015	78,043	152,588.1	2,194,058	111,689.4	264,277.5
2016 (1/2)	47,960	120,525.5	1,077,467	56,028.5	176,554.0
Total	621,740	1,770,226	12,182,522	1,040,997	2,811,222

Source: http://www.ukrstat.gov.ua/operativ/operativ2016/fin/zakup/zakup_u/zak216_u.htm

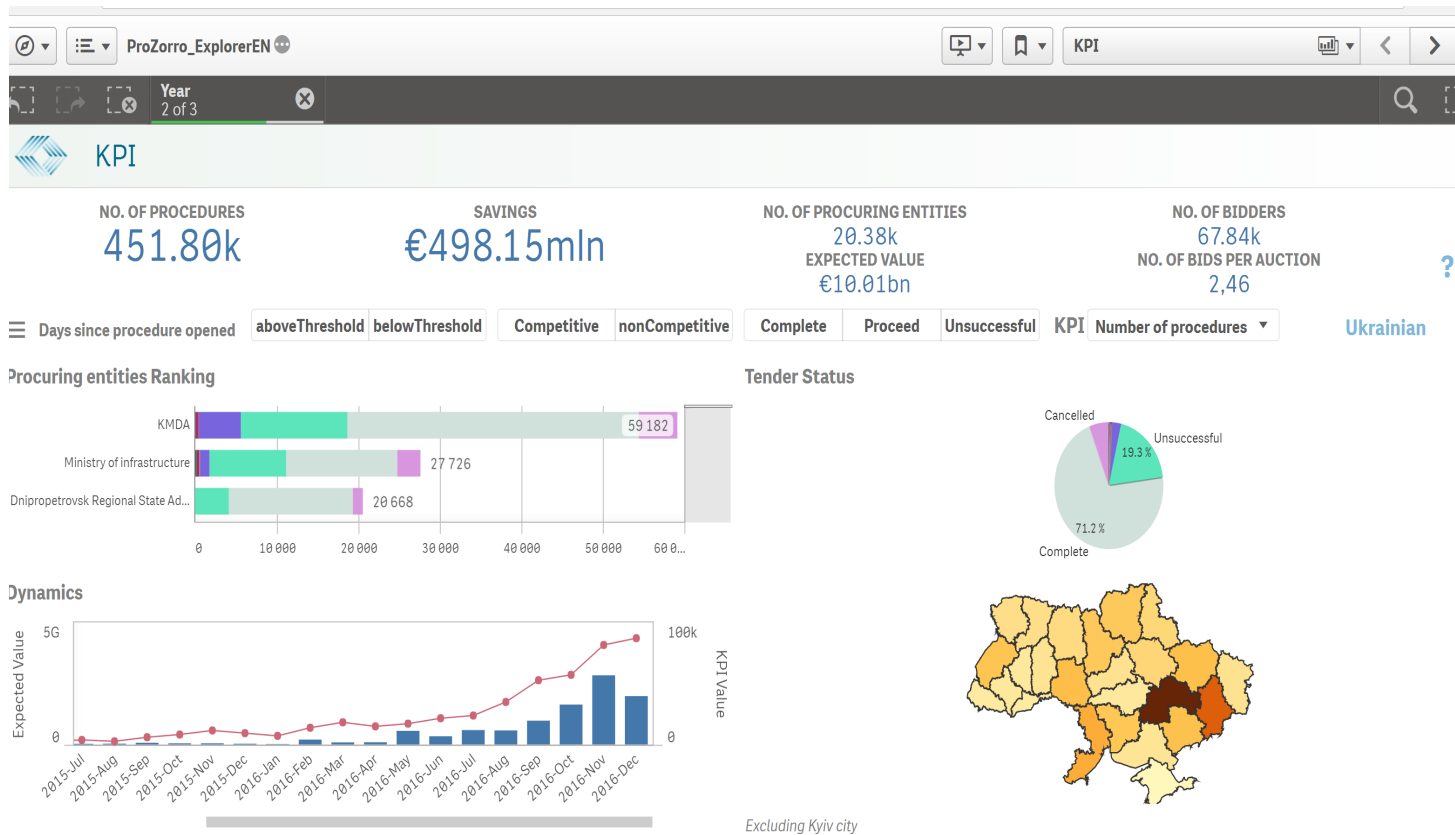
APPENDIX 3. Trust in Social Institutions and Social Groups in Ukraine



Source: December 2015, Kyiv International Institute of Sociology survey

<http://kiis.com.ua/?lang=eng&cat=reports&id=579&page=8>

APPENDIX 4. Savings (2015-2016)



Source: (available on-line at bi.prozorro.org)

APPENDIX 5. Core Prozorro Team at Prozorro's Official Launch (04/01/2016)

