

## A Lesson from South Africa: Are Construction Cartels dramatically increasing Brazil's 2014 FIFA World Cup Infrastructure Costs?

by Eddie Cottle, Paulo Capela, and André Furlan Meirinho

### Introduction

The 2008 report of the competition committee of the Organisation for Economic Co-operation and Development (OECD) into the construction sector found that, 'Unfortunately the construction industry has tended to suffer from cartel activity, as shown by the spate of well-publicised recent matters around the world'. There were 19 countries included in this OECD roundtable from Europe, Asia, North America and notably South Africa that participated. South Africa presented its report on the massive cost overruns in relation to the 2010 FIFA World Cup stadiums which it, at the time, suspected of bid-rigging.<sup>1</sup>

Through the collusive practice of bid rigging and excessive overpricing, construction companies extract or attain huge financial gains for themselves at the expense of workers and the tax payers of host countries. By implication this means the development goals that governments set themselves when hosting the World Cup are offset in part by massive transfers of wealth to private companies at the expense of job creation and income redistribution, thus stifling the economic multiplier that is intended. It is in this context that nationwide discontent emerged in Brazil involving over one million people.

From early June this year, demonstrators across major cities legitimately expressed their anger against rising transport costs, the poor quality of health and education provision, including the soaring costs of hosting the FIFA World Cup. It is important to note that this social discontent was preceded by a national wildcat strike wave which occurred between February 2011 and April 2013. Of the 25 recorded strikes at World Cup stadiums 17 were wildcat in nature involving some 30000 workers. Despite these favourable circumstances the national 'day of action' organised by eight national trade union confederations, including CUT on 11 July failed to articulate both worker and demonstrator grievances concerning the FIFA World Cup.

### Lessons from South Africa

South Africa's 2010 FIFA World Cup cost escalation was significant, and the former South African finance minister, Trevor Manuel, initially attributed the cost increases to the country's vulnerability from the 2008–09 world economic crisis. The minister failed to observe that in October 2007 the Competition Commission of South Africa set up a team to review the construction materials and services sector.

The initial cost estimate was calculated at R2.3 billion (US\$286 million) and was to be paid by the South African government, largely to fund the stadiums and related infrastructure. However, the 2010 estimated total cost (and this is likely to be much higher) for the South African government was R39.3 billion (US\$5.1 billion) – an

enormous 1709% increase from the original estimate. The stadium costs increased from the initial estimate of R1.5 billion (US\$187 million) to the latest cost estimate of over R17.4 billion (US\$2.5 billion) representing a 1008% increase.

Five major construction companies in South Africa: Aveng, Murray & Roberts, Group Five, Wilson Bayly Holmes–Ovcon (WBHO) and Basil Read were principal contractors in the building of the main stadiums for the 2010 FIFA World Cup and various related infrastructure projects, from which they have made substantial profits. In 2007 they were all under investigation by the Competition Commission of South Africa for suspected collusion and anti-competitive practices with regard to these projects. Unfortunately, the commission did not investigate the actions of international companies.

On 17 July 2013, at the tribunal of the Competition Commission of South Africa it was *conservatively* estimated that some R4.7 billion (US\$476 million) of 'unfair profits' were made by construction companies for the 2010 FIFA World Cup and other projects. They were consequently fined a total of R1.5 billion (US\$152 million). Construction companies that did not agree to the settlement now face possible prosecution.

### The Brazilian construction sector

According to the Brazilian 2014 Portal, construction companies contracted for World Cup and related infrastructure are: Odebrecht, Andrade Gutierrez, Galvão Engenharia, OAS Empreendimentos, Mendes Júnior, Via Engineering, Andrade Mendonça, Construcap, Egesa, Hap and Engevix. The two largest Brazilian construction companies involved in the World Cup are Andrade Gutierrez and Odebrecht.

As the World Cup and the Olympics draw closer, Brazil's construction sector is set to move out of its unexpected slump demonstrated by its poor performance in achieving growth of 4.2% in 2011 and 2.2% in 2012. The poor performance is related to the fact that by May 2012 only 25% of the transport projects had completed the bidding process; and by the end of the same month 41% of works for the World Cup had not yet started. The construction sector is to complete the construction of 13 airports, 7 ports and 37 transport projects and the building or refurbishment of 12 stadiums for the 2014 World Cup. The construction sector employs 2.5 million formal workers and estimates show there are 1.5 million informal workers. The delays contributed to the unemployment rate in Brazil which increased to 5.6% in February 2013.

The construction sector appears to experience dramatic fluctuations in their annual net profits. Engevix, for example, had posted -85% in 2010 but posted a 256% increase in 2011. Companies such as OAS Empreendimentos which had an increase in net profit of 2244% in 2010 had a 360% decrease in 2011. Andrade Gutierrez realised a net profit increase of 23% in 2010 and 28% in 2011 while Odebrecht reported a 148% increase in its net profit in 2010, the highest profit in its history.<sup>ii</sup> Andrade Gutierrez and Odebrecht are two companies that are responsible for 7 of the 12 World Cup stadiums.

### **Brazilian stadium costs overrun**

Brazilian and foreign construction companies such as the German architectural firm GMP are the main beneficiaries of the 2014 FIFA World Cup related infrastructure outlay which is currently calculated at US\$8 billion, with 78% of the total spending coming from public funds. According to the Brazilian Ministry of Sports, the overall economic impact will exceed US\$100 billion, creating 332000 permanent jobs (2009-2014) and 381000 temporary jobs in 2014.

The fact that by May 2012 about 41% of the works for the World Cup had not yet started led the Federal Government to change its procedures for approving projects with an 'exceptionality status' created to increase the speed of the approval rate for FIFA World Cup 2014 infrastructure projects. By implication, construction companies will opportunistically use this situation to their advantage to collude to fix the official bidding costs way above their value, resulting in enormous cost overruns which will have to be paid by the Brazilian government with public funds.

The most reliable source for the original cost estimates of each of the stadiums is contained in the Brazil 2014 Bid Book. Since, the bid book is not made public (as is the case with all bid books) it is not possible to review the original cost for each stadium. It is, however, reasonable to assume that since the Brazil Bid Book was submitted to FIFA by 31 July 2007 and the FIFA Inspection Team conducted their inspection visit on 23 August 2007, the figure in this report of US\$1.1 billion for all the stadiums is reflective of the original bid book figures. The FIFA Inspection Report of 2007 thus grossly underestimated the cost for the Brazil World Cup stadiums which increased from US\$1.1 billion by 327% in 2013, reaching a whopping US\$3.6 billion.

The cost escalations at Mané Garrincha Stadium (Brasília) and Maracanã Stadium (Rio de Janeiro) have more than doubled since 2010 and total R\$2.9 billion or US\$1.3 billion. The two stadiums alone therefore cost more than the original US\$1.1 billion for the entire FIFA World Cup stadium estimate. At the current rate of cost escalations, it is probable that Brazil could own the most expensive FIFA World Cup in world cup history.

### **Towards a construction sector cartel investigation**

The Brazilian Congress is set to decide whether or not to probe the cost overruns of the stadiums and allegations of corruption.

We believe there are sufficient grounds for the Brazilian government to open a full investigation into the operations of a construction cartel; the Competition Committee Report of the OECD, the overwhelming evidence of South Africa's Competition Commission Report, especially in relation to the 2010 FIFA World Cup, and the dramatic cost increases of Brazil's stadium costs when compared to the 2007 FIFA Inspection Team Report.

A further motivation for the need of such an investigation is the recent decision by the Sao Paulo State to 'file a lawsuit against Siemens AG (SI) to try to recover money the company allegedly overcharged the state for trains sold by a consortium to city and regional transportation networks'. This latter case should demonstrate the need to ensure that the Administrative Council for Economic Defense (CADE) involved in the Siemens investigation extends its investigation into the construction sector. Such an investigation into the affairs of the construction cartel should not be limited to Brazilian companies only but also extended to international companies involved in construction related activities.

Finally, it is necessary that the Brazilian government responds to the appeal by civil society for greater transparency and accountability in the affairs of the 2014 FIFA World Cup and make public the official Brazilian Bid Book.

- i) This preliminary report of the Institute for Latin American Studies (IELA) concerns the operation of construction cartels involved in the FIFA World Cup. The full report can be downloaded at <http://www.iela.ufsc.br/>.
- ii) At the time of writing this paper most of the companies had not yet released their 2013 annual reports which could provide a different outlook to what is being presented here as the financial position is likely to have improved as indicated earlier.

**André Furlan Meirinho has an MBA in Regional Sustainable Development from the Universidade de Brasília (UnB), Specialization in Municipal Public Law at Universidade do Vale do Itajaí (UNIVALI). He also holds bachelor's degree in Administration focusing on Marketing. He is currently completing a master's degree in Territorial Planning and Socio-Environmental Development at the Universidade do Estado de Santa Catarina (UDESC).**

**Paulo Capela is a professor at the Sports Center of the Federal University of Santa Catarina, Brazil, and is a Football and Physical Science specialist. He is a former president of the Institute of Latin American Studies (IELA).**

**Eddie Cottle is the Policy and Campaign Officer of the Building & Wood Workers International (BWI), Africa and Middle East Region. His current interests are mega-sports and labour and he is the editor of the book *South Africa's World Cup: A Legacy for Whom?* published in 2011.**