

3.4 Corruption and the bidding process for the Olympics and World Cup

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The process

Every four years the International Olympic Committee (IOC) and the Fédération Internationale de Football Association (FIFA) run an international bidding competition that ends in the awarding of the Olympics or the football World Cup to a host city or country roughly seven years before the event is held. In the case of the Olympics, the international competition is often preceded by a national competition among cities in many of the potential host countries. For instance, in February 2013 the United States Olympic Committee (USOC) sent out an invitation to 50 US cities asking if they would be interested in hosting the 2024 Summer Games. In July 2014 the USOC named four cities (Washington, Boston, San Francisco and Los Angeles) as its finalists (even though Boston had never made a formal decision to be a candidate). The USOC anointed Boston as the official US candidate in January 2015.²

The US candidate now enters into a competition with multiple 'applicant' cities from around the world. Applicant cities pay the IOC US\$150,000 for the privilege of being considered in the contest.³ In 2016 the IOC will narrow the list down to three to five 'candidate' cities; candidate cities pay the IOC an additional US\$500,000, in theory to cover the costs of the IOC's consideration of their application.⁴ The IOC will pick the 'winner' in 2017. FIFA follows a similar process and timeline, with the exception that it is countries, not cities, that host the month-long final World Cup competition. In both cases,

though, there is a fundamental, underlying economic reality: there is one seller (the IOC or FIFA), there is a monopoly, and there are multiple bidders (and more potential bidders) from around the world. In the case of the Olympics, as indicated above, the process involving the monopoly seller with multiple bidders happens in two stages, first at the country level and then at the international level, raising the expense for the participants in the bidding game.

Well beyond these payments to the IOC or FIFA are the costs entailed in putting together a plan, hiring consultants, producing glossy brochures and videos, purchasing insurance, exploring financing options with investment bankers and public bodies, hosting IOC or FIFA executives, travelling to IOC or FIFA meetings, and so on. Chicago spent around US\$100 million in its failed bid to host the 2012 Summer Olympics.⁵ Other cities and countries have reported similar sums, or more: Tokyo supposedly spent US\$150 million in its failed bid to host the 2016 Summer Games.⁶

In November 2014, as part of an effort to enlist more applicants, the IOC released a set of proposed reforms to make it less expensive for cities to bid. Other than some hortatory language, the only concrete change is that the IOC would pay for some of the travel expenses for applicants to attend meetings. In sum, the savings here will be a few hundred thousand dollars per applicant -- a small token relative to the tens of millions of dollars typically expended in a bid.

The Netherlands has been considering a bid to host the 2028 Summer Games. According to a study by RTLnews, the largest commercial broadcaster in the country, as of 2012 the

Dutch had already spent US\$105 million in direct costs to study the feasibility of hosting, draw up preliminary plans, mobilise the relevant parties, and organise events ‘to entice IOC members to vote for us’.⁷ At the time of writing (late August 2014) the Netherlands has not made a formal decision on whether to bid for the 2028 Games.

The voters at the IOC and at FIFA have appreciable power to sway the choice of a host. Examples from Nagano, to Salt Lake City, to Qatar abound of vote processes that have been tainted by payoffs.

What follows is a stylised model of the bidding process. The model presents three possible situations or cases under different assumptions, going from the least realistic (case 1) to the most realistic (case 3).

Case 1

- Perfect information and no principal–agent problem
- Outcome: expected net gains are bid away

In this case, it is assumed that the IOC or FIFA each has complete information about the bidders and that each of the bidders has complete information about its own bid and those of its competitors. It is further assumed that there is no principal–agent problem; this means that the body representing the city or country (the local organising committee) fairly represents the interests of the entire resident population: the local organising committee is the agent of the entire resident population (the principal). With the assumption of perfect information, each bidder will know what its potential gain is from hosting and will continue to bid until just before its gain is fully eroded. (In theory, if each bidder also knows the

gains of other bidders, it will stop bidding at just above the gain to the second highest bidder, leaving a small potential gain.) Note that if the overall return to hosting approaches zero, and if there are feel-good benefits from hosting, this implies that there will be a negative financial result – that is, the host will have to pay to achieve any feel-good effects, bringing the overall net return to zero.⁸ This case is the most favourable for the bidding cities or countries. It is also the least realistic of the three cases.

Case 2

- There is imperfect information and no principal–agent problem
- Outcome: winner’s curse and net loss

The sole difference between this case and the prior one is that the assumption of perfect information is dropped, making case 2 a better approximation of reality. In this case, each bidder does not know what its potential benefits and costs are when it participates in the bidding competition. The winning bid in such a case usually goes to the most exuberant bidder, which not only outbids all the other bidders but also generally bids higher than the possible gain (the winner’s curse). The result is a net financial loss and a net overall loss, even though the organising committee (agent) in this case is still assumed to fairly represent the interests of the local population (the principal).

Case 3

- There is imperfect information and a principal agent problem
- Outcome: outlandish overbid

This case takes a step closer to reality by dropping one more assumption and acknowledging the existence of a principal–agent problem – in this case that the organising

committee (agent) is controlled by the private interests that stand to gain the most from hosting, and that these interests are not coincident with those of the population. There is still imperfect information, which facilitates extravagant bids from each of the prospective hosts. The expected outcome is substantial financial and overall losses, which will only be exacerbated by cost overruns once construction begins.

A corrupted process

There are two manifest opportunities for corruption in this process. First, there is the exploitation by FIFA and the IOC of the bidding cities. The monopoly market power of the two organisations enables them to extract enormous rents out of the bidding process. In order to win the bid, cities and countries have to yield to the extravagance and gigantism of FIFA and IOC expectations. The costs of the bidders and the eventual ‘winner’ explode, as do FIFA and IOC revenues.⁹ The costs are paid overwhelmingly by the taxpayers. The revenues from the event in substantial measure are not shared with the host city or country, but are retained by FIFA and the IOC for sport development and to defray high executive salaries – and, in the case of FIFA, plethoric operating expenses and ballooning reserve funds.¹⁰

Sepp Blatter, the FIFA president, earns a salary in excess of US\$1 million on top of what seems like an unlimited expense account. Other FIFA executives earn compensation packages well into six-figures sums.¹¹ Blatter had been giving the 25 members of the FIFA Executive Committee annual bonuses ranging from US\$75,000 to US\$200,000 a year on top of their salary of US\$100,000 for very part-time work. For appearances’ sake, the practice of annual bonuses was ended in 2014, but FIFA’s Sub-Committee on

Compensation (an appointed body of Executive Committee members)¹² made up for this by secretly voting to double their pay to US\$200,000, according to documents uncovered by the London *Sunday Times*. The *Sunday Times* also reported that Executive Committee members receive a US\$700 per diem while doing FIFA work, travel via business class and stay in five-star hotels.¹³ FIFA and its six regional confederations host myriad meetings in exotic locations each year, paying for the best hotels, restaurants, entertainment and transportation for the participants.

At the end of the four-year cycle that came with the conclusion of the 2010 South African World Cup, FIFA took in a surplus of US\$631 million, which raised FIFA's accumulated reserve fund to US\$1.3 billion. The anticipated surplus from the 2014 World Cup in Brazil is larger still, and the reserve fund will likely surpass US\$2 billion by the end of 2014.

While the members of the International Olympic Committee, including its president, Thomas Bach, are unpaid, Bach receives luxury housing in Lausanne and a lavish expense account. The IOC and its various committees hold frequent meetings around the globe, stay in five-star hotels and enjoy improvident spending budgets. At the end of 2012 the IOC reportedly had a reserve fund of US\$558 million.¹⁴

The second opportunity for corruption arises from the capture of the host city by economic interests. In either democratic or authoritarian countries, the tendency is for event planning to hew closely to the interests of the local business elite.¹⁵ Construction companies, their unions (if there are any), insurance companies, architectural firms, media companies, investment bankers (who float the bonds), lawyers and perhaps some hotel or restaurant

interests may get behind the Olympic or World Cup project. They stand to gain substantially from the massive public funding. Typically, these interests hijack the local organising committee, hire out an obliging consulting firm to perform an ersatz economic impact study, understate the costs, overstate the revenues and go on to procure political consent.¹⁶ According to one study, in the build-up to hosting the 2010 World Cup the average profits of the 'Big Five' construction companies in South Africa rose from ZAR158 million (some US\$25 million) in 2004 to ZAR1.67 billion (some US\$200 million) in 2009 – a 10.5-fold increase in rand terms!¹⁷

Thus, while the taxpayers of the city or country stand to lose from the bidding process and from hosting the event, the private interests that coalesce to push the hosting project stand to gain handsomely. Here, as elsewhere, the political process is corrupted.

Notes

¹ Andrew Zimbalist is the Robert A. Woods Professor of Economics, Smith College, Northampton, Massachusetts. This article is adapted from his book *Circus Maximus: The Economics of Hosting the Olympics and World Cup* (Washington, DC: Brookings Institution Press, 2015).

² "Boston wins USOC bid to host 2024 Olympic Games". WCVB-TV. 8 January 2015, at <http://www.wcvb.com/sports/boston-wins-usoc-bid-to-host-2024-olympic-games/30599954>

³ See for example, IOC 2022 Candidature Acceptance Procedure, at http://www.olympic.org/Documents/Host_city_elections/2022-Candidature-Acceptance-Procedure-FINAL-with-cover.pdf, p.25

⁴ *Ibid.*

⁵ CNN, 'Chicago loses Olympic bid to Rio', 2 October 2009, at http://money.cnn.com/2009/10/02/news/economy/chicago_olympics_rejection/

⁶ The Asahi Shimbun, 'Mizuno says Tokyo 2020 bid budget will be slashed', 3 December 2011, at http://ajw.asahi.com/article/behind_news/sports/AJ201112030021

⁷ Michel de Nooij, 'Mega Sport Events: A Probabilistic Social Cost–Benefit Analysis of Bidding for the Games', *Journal of Sports Economics*, vol. 15 (2014), p. 412. The indirect costs are estimated at an additional US\$142 million.

⁸ Note that cities and countries do not bid with US dollar figures. Rather, they bid with fancy facilities and appealing infrastructure and amenities. Since these have a price, their bids can be translated into US dollar figures.

⁹ See Bent Flyvbjerg & Allison Stewart, 'Olympic Proportions: Cost and Cost Overrun at the Olympics 1960-2012', Said Business School (Oxford: University of Oxford, 2012).

¹⁰ Merco Press, 'FIFA with record revenue and cash reserves, after 2014 World Cup', 23 March 2015, at <http://en.mercopress.com/2015/03/23/fifa-with-record-revenue-and-cash-reserves-after-2014-world-cup>

¹¹ See <http://leastthing.blogspot.com/2013/06/further-thoughts-on-sepp-blatters-fifa.html>.

¹² According to Domenico Scala, a member of the three-man Compensation Sub-Committee, the pay levels chosen are meant to emulate the compensation paid to executives in similarly sized companies in the private sector:

www.fifa.com/aboutfifa/organisation/footballgovernance/news/newsid=2384045/index.html.

¹³ *Sunday Times* (UK), 'Fifa's chiefs pocket secret 100% pay rise', 22 June 2014.

¹⁴ *Chicago Tribune* (US), 'Pay IOC president? Yes, but...', 26 April 2013.

¹⁵ See Andrew Zimbalist, *Circus Maximus: The Economic Gamble Behind Hosting the Olympics and the World Cup* (New York: Brookings Institution Press, 2015)

¹⁶ *Ibid*

¹⁷ Eddie Cottle (ed.), *South Africa's World Cup: A Legacy for Whom?* (Durban: University of KwaZulu-Natal Press, 2011).