EU AND INTERNATIONAL PUBLIC PROCUREMENT

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Di SHI
Presentation Outline

- Introduction to Public Procurement
- Theoretical Foundation of Public Procurement----Intuitive Auction Theory
- Problems with Public Procurement
- Public Procurement Regulations----Worldwide and the European Union
  - WTO Agreement on Government Procurement (GPA)
  - EU Public Procurement Law and Policies ---- Inside and Outside
- Brief Case Studies
  - Hungary—Serbia Railway
  - Paks II Nuclear Power Plant
**Introduction to Public Procurement**

**What is Public Procurement?**

The process by which public authorities, such as government departments, local authorities at different levels, or bodies governed by public law, purchase work, goods or services from companies.

**What is the Object of Public Procurement?**

*Almost everything is possible!*
The Importance of Public Procurement

- Major component of government spending
  - To boost investment, trade, job creation, economic growth
- Public procurement as public policy instrument
  - Public procurement represents an important strategic instrument in the governance agenda and public policy to accomplish particular policy objectives (e.g., Environment, Social Integration, Innovation

Green Public Procurement

The Size of Public Procurement Market

- Account for 10-15% of the GDP of an economy on average
- Every year, over 250,000 public authorities in the EU spend around 14% of GDP on public procurement (around 2,500 billion euros)
Introduction to Public Procurement

How Public Procurement is conducted?

Open Procedure
Restricted Procedure
Competitive Procedure with Negotiation
Competitive Dialogue
Sole Source Procurement
Innovation Partnership

The main phases of public procurement procedures

Preparation
Identification of need
Project preparation
Preparation of tender documents
Selection of the type of procedure
Specification of selection/award criteria
Opening, assessment and evaluation of tenders
Resolution of any problems Amendments to contract, etc.

Pre-tendering phase
Publication of tender
Signature of contract and notification of contract award
Final handover report

Tendering procedure
Payments to contractor

Contract management
Source: European Court of Auditors.
Theoretical Foundation of Public Procurement

---- Auction Theory

**Auction:** Mechanism for allocating scarce resources among self-interested agents

**Key Factors in Auctions:** Information, Valuation, Bidding Price

**Typology:**
- **Open Auctions**
  - English Auction (ascending)
  - Dutch Auction (descending)
- **Closed Auctions**
  - First-Price Auction
  - Second-Price Auction

Whether information on other bidders is available
Optimal Bidding Strategy in First-Price Auction:

- There is a tradeoff between the probability of winning the bid and the amount paid upon winning.

\[ \text{Payoff} = \begin{cases} (V_i - b_i)p & \text{win} \\ 0 & \text{lose} \end{cases} \]

- Bidders have to take into account what other bidders are going to offer. There is no dominant strategy.

In a first-price auction with \( n \) bidders with independent private values \( v_i \) drawn from a common uniform distribution, the symmetric equilibrium bidding is for each bidder to submit a bid:

\[ b(v_i) = \frac{(n-1)}{n} \cdot v_i \]

Implication: the larger the number of bidders, the more the auctioneer will gain.
Collusion among Bidders----Bid Rigging Cartel

Public procurement rules do not change much over time. Once the awarding rules are fixed by existing law, the potential contractors have first to decide whether they are going to compete or to cooperate at the expense of the public buyer.

The decision in favour of cooperation depends on:
• How the contract is allocated among members of the coalition (Internal allocation rule)
• How to share the monopoly profit arising from the cooperation (Profit-sharing rule)
• How to enforce the agreement if it is not self-enforcing (Detection and penalty procedure)

Hardship to detect collusive agreement among bidders
PROBLEMS IN PUBLIC PROCUREMENT

• It weakens the rule of law.
• Leads to vulnerable public institutions.
• Suboptimal quality of public services.
• Inefficient use of resources.

1. Companies perceived rigidity of public procurement
2. They do not take part in the bid
3. Lack of competitive tenders
4. The public loses out

Costs the EU €5 billion per year.
PROBLEMS IN PUBLIC PROCUREMENT

DISCRIMINATORY TREATMENT OF FOREIGN BIDDERS

Negative effects:

Uncertainty and high transaction costs for suppliers and purchasing agencies.

Rent-seeking (lobbying) by local firms to the detriment of the local taxpayers and foreign firms.

Creates trade barriers. Damaging

Free market entry

Competition

Efficient markets
INTERNATIONAL PUBLIC PROCUREMENT

- GATS negotiations on government procurement
- Doha Development Agenda (DDA) Working Group
- Agreement on Government Procurement (GPA)

Liberalisation of government procurement markets
GATS negotiations and Doha Development Agenda

**THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS):**

“There shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force of the WTO Agreement” (1995). Article XIII

  - Study to achieve a potential agreement on transparency considering national policies on public procurement.
- 2001: In the WTO’s Fourth Ministerial Conference of Doha a future agreement and wishes of carry on negotiating a multilateral agreement in transparency in PP.
- 2004: Because of lack of consensus work was suspended following a decision of the General Council.
WTO Government Procurement Agreement GPA

- Binding international treaty aiming to open international government procurement markets among its parties.


- Continuous revisions of the GPA, last: 6 April 2014.

“Parties shall undertake further negotiations (...), progressively reducing and eliminating discriminatory measures, and achieving the greatest possible extension of its coverage among all Parties on the basis of mutual reciprocity and taking into consideration the needs of developing countries.”

Article XXII.7
WTO Government Procurement Agreement (GPA)

- **A plurilateral status:**
  19 over 47 members of the WTO.
  29 WTO members + 4 international organizations as observers.
  9 in process of acceding.

- **International Organisations:**
  IMF.
  OCDE.
  United Nations Conference on Trade and Development
  International Trade Centre

Source: WTO
WTO Government Procurement Agreement (GPA)

**STAGES OF THE ACCESSION PROCESS:**

1. Submission of an application for accession.
2. Negotiations between parties on the former's coverage offer.
3. Verification of acceding member's legislation consistent with the GPA's requirements (transparency, etc).
4. The Committee on Government Procurement (composed of parties + observers + inter-governmenntal organisation representatives) invites the member to accede to the GPA.
WTO Government Procurement Agreement (GPA)

**BENEFITS**

- Market access.
- External validation of its procurement reforms,
- + attractive place for foreign investments

**PRINCIPLES**

- National treatment and non-discrimination
- Transparency openness, objectivity and legitimacy in public contracts
- Globalisation

**PROCUREMENT DISPUTE MECHANISMS**

- **Domestic review systems:** National legislation suitable to the GPA. [Authority-supplier]
- **Dispute settlement:** Proceeds between parties when considered violation of the GPA.
Discriminatory treatments of foreign bidders (out of the GPA):

- Not all WTO members are parties to the Agreement.
- The GPA has not been able to attract major emerging economies, which generally remain reluctant to open up their national GP to international competition.
- The GPA did apply only to those sectors the parties had agreed to commit under the agreement ("coverage schedules").
## WTO Government Procurement Agreement (GPA)

### Covered Excludes:

Only exceeding specified procurement threshold values are covered by the Agreement.

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<thead>
<tr>
<th>Party Name</th>
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<th>Services</th>
<th>Construction Services</th>
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### Thresholds 2016 (1,000 €)

- **Armenia**: Goods 134.940, Services 134.940, Construction Services 5.225.000
- **Canada**: Goods 134.940, Services 134.940, Construction Services 5.225.000
- **European Union**: Goods 135.000, Services 135.000, Construction Services 5.225.000
- **Israel**: Goods 134.940, Services 134.940, Construction Services 8.882.500
- **Japan**: Goods 103.800, Services 103.800, Construction Services 4.702.500
- **Korea, Republic of**: Goods 134.940, Services 134.940, Construction Services 5.225.000
- **United States of America**: Goods 134.940, Services 134.940, Construction Services 5.225.000
EU Policies on Public Procurement

- What is behind the policies on PP? – discretion v. compliance formula
- EU conflicting policy preferences
- EU PP Reform, 2016
- EU openness in GP
- Recent developments in the EU PP:
  - “Buy European” Procurement Regulation
  - Fair Trade Public Procurement
Compliance v. Discretion in GP policies

- Integrity v. best quality
- Stylyzed Formula
  - $C = M + D - A$
- C: Corruption
- M: Monopoly
- D: Discretion
- A: Accountability

Clarity of process and criteria essential from the compliance perspective

EU Anti-Corruption Report

Source: Brookings Scholar Lecture Series, Jeffrey Gutman – April 15, 2015
Conflicting EU policy preferences

- EU level - the choice of liberalization of PP and the fundamental principle of national treatment in international instances, non-discrimination VS Member States - preference for keeping GP as a tool of industrial policy
- a social policy
- Government’s ability to regulate GP is being tightened by the international rules of the General Agreement on Tariffs and Trade (GATT) or the Government Procurement Agreement (GPA)
- PP continues to absorb a major proportion of GDP, averaging 20% in most industrialized countries, as one of the few significant economic policy instruments remaining for national governments in the present context of budgetary constraints
EU PP Reform, New Directive 2014/24/EU

- eProcurement
- New opportunities for SMEs
- Simplifying the rules
- More competition with new rules on concessions
- Facilitating procurement cooperation among public authorities
- Creating a culture of integrity and fair play
- Supporting social responsibility
### EU openness in procurement: The Ramboll study on the relative openness of the EU PP

<table>
<thead>
<tr>
<th>Country</th>
<th>Ratio 1 (Total public imports to public demand)</th>
<th>Ratio 2 (Estimated public imports intra-EU to total imports)</th>
<th>Ratio 3 (Extra-EU public imports to public demand)</th>
<th>Ratio 2b (Ratio 2 required for EUMS to be as open as Japan)</th>
<th>Ratio 4 (Intra-EU public imports to public demand)</th>
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Source: Messerlin, How open are public procurement markets?
GDP and ratio 1
(share of total public imports in public demand)

GDP and ratio 3
(share of extra-EU public imports in public demand)
Recent developments of the EU PP:

- ‘Buy European’ Procurement Regulation or an International Procurement Instrument (IPI):
  - an imbalance between the openness of the EU procurement market and third country procurement markets

- Amendments to the proposal 2016

- Fair Trade Public Procurement:
  - Market Analysis
  - Needs Assessment
  - Political commitment
  - Awareness-raising towards the general public
  - Choosing a suitable pilot contract

![Figure 1. Newly introduced public procurement measures by level of restrictiveness at global level, number of measures, 2008-14](source.png)

Source: GTA database.

- IS THERE ROOM FOR DISCRETION? REFORMING PUBLIC PROCUREMENT IN A COMPLIANCE-ORIENTED WORLD - Jeffrey Gutman Global Economy and Development at BROOKINGS
  How open are public procurement markets? RSCAS 2015/89
  Robert Schuman Centre for Advanced Studies Global Governance Programme-204
  Patrick Messerlin EUI Working Paper

- Buying Fair Trade European Model on Fair Trade Public Procurement

- Amended Proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union’s internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries Brussels, 29.1.2016 COM (2016) 34 final 2012/0060 (COD)
Brief Case Studies

Hungary—Serbia Railway

A more capable and more efficient rail connection between Budapest and Belgrade

- Length: 350km (166km in Hungary + 184km in Serbia)
- Speed: Max 200 km/h
- Flagship project of China’s “One Belt, One Road” Initiative in CEE to enhance connectivity
- First discussed in 2013, deal signed by three governments in 2015
- Contract for the Hungarian section directly awarded to a consortium comprised of Chinese and Hungarian state-owned railway enterprises with preferential financing from Chinese policy bank
- Preliminary compliance investigation launched by the Commission with Hungarian government
**Brief Case Studies**

**Paks II Nuclear Power Plant**

Paks Nuclear Station: the key power plant for the electricity supply in Hungary built in Soviet era

Paks II Project: New nuclear reactors to replace the four existing ones

**Controversy:**

Hungarian government awarded the project contract to Russia’s state nuclear power holding Rosatom, claiming that only Russian company could meet its technical requirements.

(Article 40(3)(c) of Directive 2004/17/EC: a procedure without prior call for competition when for technical reasons the contract may be executed only by a particular economic operator.)

The U.S.-based nuclear technology company Westinghouse questioned the claim.

Distortion on regional electricity market

Political Concern: EU’s intention to reduce reliance on Russian energy