

Governance risks in public procurement explored

Some policy dilemmas and
Norwegian illustrations

Old, new and perennial reasons for public procurement

- 1) Public tasks, only private capacity
- 2) "Build the country": complement private demand to build scale-efficient (Statoil) or import-saving national capacity. Stimulate innovation
- 3) Substitute public with private task-solving of public tasks due to higher private efficiency (easier to organize *competition* or to draw on foreign task solving capabilities giving lower price, better solutions)
- Higher downwards expense- flexibility. In the absence of slack and financial reserves also higher upwards task solving ability (Norwegian kinder gardens). With slack much lower: New Orleans

Public procurement, bidding rules and corruption

- Corruption obviously a governance issue in public procurement
- Political patronage another issue (giving undemocratic mileage to incumbent)
- Transparent, competitive bidding rules as 1)a remedy against both
- 2) stimulate fair competition, lower public expenses. If so,
- 3) Substitute public with private organizations

The competition metaphor: Bid and regular competition compared

- Regular and bid competition: competition between suppliers may decrease costs,
- Regular competition: increase quantities, bid competition: quantity given
- Regular competition: new products, services, bid competition (extreme): given task.
- Regular competition: more suppliers: lower prices, bid competition: ?
- Regular competition: unsuccessful suppliers produce, bid competition: unsuccessful suppliers pure waste
- Regular competition: corruption minor role for contracts, bid competition: potentially important

The backside of competitive bidding

- 1) Downward pressure on workers' rights and economic living conditions (Berge & Sønsterudbråten 2011)
- 2) If too short-term, underinvestment in complementary task-specific human and real capital
- 3) While possibly more difficult to perform, corruption remains since still p.p. and incentives even stronger.
- 4) Transparency may reduce corruption, but ease cartelization and industrial espionage
- 5) Reduces flexibility in public-private interactions. Increases transaction costs
- 6) makes innovation more difficult to stimulate by p.p.
- In the following we will focus on 3) -5).

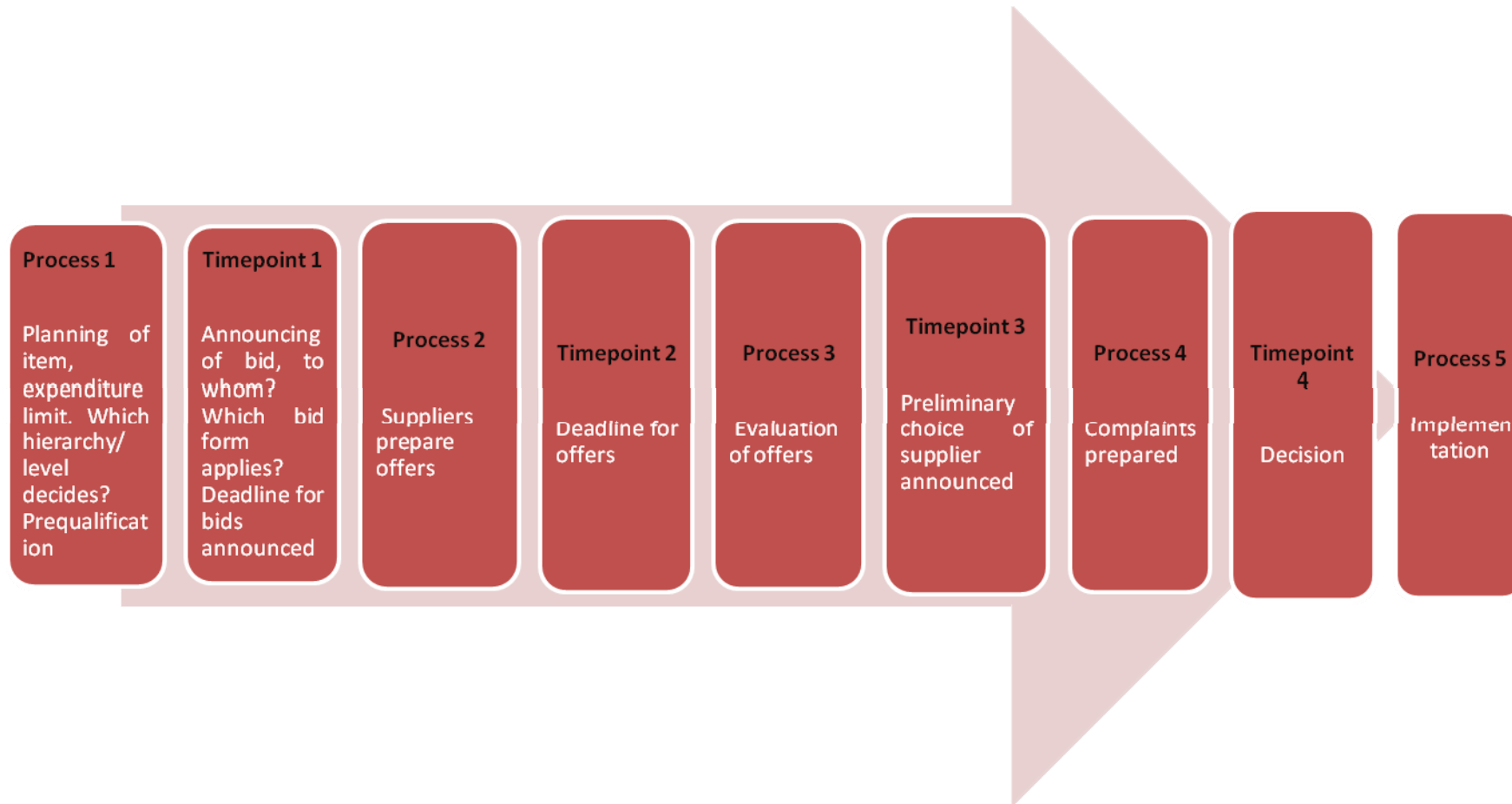
EU and public procurement rules

- EU most important to implement and fix common set of rules. Anti-corruption part of their legitimation.
- Reduce scope for single-state patronage
- Common market for public procurement only a metaphor, but relevant in a few situations.
- Less cross- border supply than one could expect: 1.6% awarded recently to abroad member operators.(Statistics correct?)

Various economic dimensions of public procurement in Norway

- *16 % of GDP*, 380+ billion NOK, central government 170, local government 130, enterprises 80+ in 2009.
- EU tender base received 5000- notifications, DOFFIN 8000+.
- *830 000 suppliers* involved, and 1400 different public procurement institutions
- Investment in oil industry 100 billion *per year*, planned for investment in rail and roads for next *decade*: 100 billion.

Figure 1. Stylized sequence in public procurement processes



Bid competition components

- 1) Where auction is to published? ex. TED
- 2) Qualification criteria
- 3) Who is allowed communicate with whom, when and about what.
- 4) rules for the evaluation process
- 5) Complaints process
- 6) Sanctions
- 7) Change order rules in implementation

Major bid competition forms. EU

- No obligatory bidding below 500 000.
- *Open procedure*, auction of all willing to participate who are *qualified*. No info shared
- *Restricted procedure*. Auction among a given set of *prequalified* suppliers. No info shared.
- *Competitive dialogue* Info shared at the outset between subset of suppliers. Then auction.
- *Competitive negotiated procedure*. Dialogue at the outset, then dialogue with a subset of the subset of suppliers.

Scattered empirical observations

(Asia) government pay on average 21% more than private org (Cole 2009)

(Asia) *Best value auction* most corruption, *no bid* intermediate and *least price* least corrupt (Tran 2008)

(Northern California, 1995) 97% of public building contracts based on competitive bidding, only 18% of contracts in private non-residential building are so

Choice of bid rules in Norway

- TED: 92% most advantageous offer, 8% lowest cost, 30% framework, 17% negotiated procedures.
- DOFFIN: 89% most advantageous offer, 11% lowest cost, 13% framework, 3.5% negotiated procedures.
- If true, high corruption risk rules chosen
- *Conflicting evidence*: (Berge & Sønsterudbråten, 2011): in practice lowest cost dominates in security, cleaning and construction. Non-price considerations only in qualification judgements. Why dominance of lowest price?
- What do the violation of bid rules signal? corruption, that they are impractical? Aftenposten's 2008 UD survey 122 consultancy cases, 50% violations

Characteristics of recent Norwegian corruption cases

- Procurement sites located in hybrid public private organizations overrepresented
- Employees moving from private sector overrepresented carrying old networks
- Construction and IT services overrepresented
- Public organizations undergoing fast change (weak monitoring) overrepresented
- Employees organizing large number of bids are overrepresented
- Main policy failure of large scale projects: lack of understanding of impartiality considerations.

Corruption and cartelization compared

- Corruption: procurement rent shared between procurer and one supplier. Cartelization: procurement rents shared among suppliers
- Increasing bid transparency: facilitate cartelization, makes corruption more difficult
- Cartelization and corruption may be competitive or complementary. Both violate bid competition rules
- Cartelization may be large scale, corruption never legitimate, cartelization was legitimate. Large scale cartel but so far no cor.cases do occur in the Nordic countries.
- Both human adaption to excessive uncertainty generated by bid competition where winner takes all?