The economic impact of the EC procurement policy

Ekonomický dopad politiky EU v oblasti veřejných zakázek

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Abstract: The economic impact of the EC procurement policy is an important aspect of public procurement in the most areas of industry and agriculture. There exist some studies about the economic impact of the EC procurement policy. The first major study was the one commissioned by the European Commission and published in 1997 as a part of a broader evaluation of the European single market. This dealt with the period from 1987 when the directives were substantially revised, to 1994. In February 2004, the Commission published a new summary analysis of the economic impact of the EC rules covering the period 1995–2002. A report on the functioning of public procurement markets in the EU: benefits from the application of the EU directives and challenges for the future (EC 2004). This confirms a much greater importance of the indirect cross-border activity as compared with the direct cross-border binding activity, and also indicates that this form of trade in public markets has increased further. The above mentioned studies in relation to the Economic Impact of the EC procurement Policy are the object of this article.

Key words: public procurement, economic impact of EC procurement policy, industry and agriculture

Abstrakt: Ekonomický dopad politiky EU v oblasti veřejných zakázek je důležitým aspektem zadávání veřejných zakázek v mnoha oblastech průmyslu a zemědělství. Existuje více studií, které se ekonomickým dopadem politiky EU zabývají. První klíčová studie byla vypracována Evropskou Komisí a publikována v roce 1997 jako část širšího hodnocení Jednotného evropského trhu. Tato studie se týká období od roku 1987, kdy byly směrnice pravidelně revidovány, do roku 1994. V únoru 2004 Komise publikovala novou shrnující analýzu ekonomického dopadu politiky EU na oblast veřejných zakázek zahrnující období 1995–2002: Zpráva o fungování trhu veřejných zakázek v EU: výhody z aplikace EU směrnic a výzvy pro budoucnost (EC 2004). Tato zpráva potvrdila značný význam nepřímé přeshraniční aktivity ve srovnání s přímou přeshraniční aktivitou v předmětné oblasti a rovněž potvrdila, že různé formy obchodních vztahů v oblasti veřejných zakázek mají vzestupnou tendenci. Výše uvedené studie (jejich analýza) ve vztahu k ekonomickým aspektům politiky EU v oblasti veřejných zakázek jsou předmětem tohoto článku.

Klíčová slova: veřejné zakázky, ekonomický dopad politiky EU v oblasti veřejných zakázek, průmysl a zemědělství

INTRODUCTION, MATERIALS AND METHODS

A number of studies have examined the economic impact of the EC procurement policy. The first major study was the one commissioned by the European Commission and published in 1997 as a part of a broader evaluation of the European single market. This dealt with the period, when the directives were substantially revised, to 1994[1] and was based on the survey of procuring entities and suppliers, as well as statistical data. Other early studies, including academics, are largely consistent with its findings.[2] In February 2004, the Commission published a new

Supported by the Ministry of Education, Youth and Sports of the Czech Republic (Grant No. MSM 6215648904) and within the framework of the institutional research of the Faculty of Business and Economics, MUAF Brno.

[1] There was enforced the right that certain states are entitled to benefit from the rules in the procurement regulations to the same extent as the EC Member States. Currently, the states that are designed as the relevant states are the states covered by the European Economic Area (e.g. Norway) and "Europe Agreements".

[2] Other studies e.g. Madsen (2003), p. 265.

summary analysis of the economic impact of the EC rules covering the period 1995–2002. A report on the functioning of public procurement markets in the EU: benefits from the application of the EU directives and challenges for the future (EC 2004). These studies provide data both on changes in the cross-border trade in public procurement and on the extent of the resulting benefits.

RESULTS AND DISCUSSION

Regarding changes in the cross-border trade, the 1997 EC study found that the overall rate of import penetration in public market increased from 6 per cent to 10 per cent between 1987 and 1994. Of this, direct imports (purchases from a supplier outside the state of the procurement entity) increased from an average of 1.4 per cent to 3 per cent and indirect imports (purchases of foreign products or services from suppliers based inside the procuring entity's state) formed 4.5 per cent to 7 per cent. The 2004 EC report does not provide any directly comparable data, but reports the results of a survey of the cross-border bidding activity of 1 500 firms, completed in 2003 (EC 2004, pp. 8–13). This confirms a much greater importance of the indirect cross-border activity as compared with the direct cross-border binding activity bidding, and also indicates that this form of trade in public markets has increased further.

Whilst these data show that trade has increased, they do not necessarily indicate that the directives have produced economic benefits. To assess whether savings had been made either because of a greater import penetration or because of other anticipated effects (such as restructuring of lower prices by domestic suppliers), both the 1997 EC study and the 2004 EC report examined whether prices converged between Member States. The 1997 EC study concluded that in relation to strategic products – that is, high technology products bought mainly by the public sector – there had been significant savings in limited sectors, namely cardiac monitors, buses and office machinery, and that these savings were due to the directives.[3]

However, in most of the strategic sectors examined no real savings were seen as a result of the directives, and in relation to commodity products – standard products bought by both public and private sectors – again no real savings were seen (although there were a few instances of the individual procuring entities obtaining a better value by applying the directives). The 2004 EC report concludes, however, that there have been further savings in strategic product areas (EC 2004, pp. 18–20). The report analyses seven product sectors, chosen for their homogeneity in order to facilitate price comparisons. These were preparations for X-ray examinations, iron or steel railway rails, smaller rails for trams, iron and steel seamless pipes (of the kind used for oil or gas pipelines), fire fighting vehicles, railway tank wagons and syringes for medical usage. For six of the products (all but medical syringes), export and import prices have shown a trend towards convergence, and the trade in the public sector has also expanded faster than the extra-EC trade and than the private sector trade in the same products, indicating that the convergence effect was due to the directives.

The 2004 EC report also found significant price savings in procurements in which notices were published and received at least one response, as compared with the cases of direct contracting with one firm: after controlling for other factors /such as the quantities ordered). It concluded that the savings were in order of around 40 per cent (EC 2004, pp. 14–16). However, whilst this shows that the open competitive purchasing reduces prices, it does not follow that price improvements are brought about by the directives as such: without the directives, purchasing might be carried out under even more efficient competitive processes established by the national procurement regimes.

Overall, as the 2004 EC report concludes, these data suggest that the directives have produced some economic benefits, but that there is also the potential for futher savings. There are, however, no recent data for making an overall assessment of the potential and likely benefits, including whether there are as great as identified in the Atkins report.

Some commentators have criticised the EC policy on the basis that it is based on the assumption that trade takes place through cross-border tenders when in fact most trade in public markets occurs – and seems likely to occur – through indirect imports.[4] This is borne out by the data above and it may be the case that tenders across borders, in particular, may be expected to be lower in the public than private sectors.

It is also true that the EC policy was probably conceived with the view to develop trade mainly through

[3] For telecommunications, the qualitative analysis suggested that savings were made due to privatisation and liberalisation of the telecommunications industry, which led to more commercial practices, rather than to the directives.

[4] See, for example, Cox and Furlong (1997).

the tenders across borders: in particular, the directives high thresholds, which exceed those traditionally used for competitive procurement under national rules, are set mainly based on the levels at which bids are likely to be worthwhile from firms tendering from other Member States. However, transparency rules can safeguard against hidden discrimination against bids with foreign content as well as bids from foreign suppliers. The EC jurisprudence, indicating that the Treaty imposes positive obligations in relation to the award of below threshold contracts and that the directives are enforceable by domestic firms as well as those from other Member States, now helps to ensure that there is no discrimination against bids with foreign content.

The above studies and some other point to a number of other factors that are relevant to the success of and limitations of the EC policy, as revealed by the data so far.

One factor that would be expected to affect the success of the regime is the extent to which the entities actually follow the rules. In this respect, the 1997 EC study found a low level of compliance with advertising obligations.[5] The Commission database showed that at least 100 000 entities should have published some notices advertising contracts in the Official Journal, but only just over 15 000 – a mere 14 per cent – were doing so by 1994.[6] Further, the study found that of the advertised contracts, the entities published contract award notices only for about 50 per cent, a figure supported by other studies.[7] The low compliance rate was attributed both to the lack of clarity in the rules – especially over coverage – and to the inadequate enforcement. Enforcement in many Member States has, however, improved significantly since 1994. Interestingly, the study was not able to find any link between the implementation in domestic law in each Member State and the levels of compliance; indeed, some Member States showed a relatively high actual compliance with directives that had not been implemented at all. This may be because the entities that are aware of the directives are also aware that they have a direct effect and thus can be enforced even if not implemented.

Figures in the 2004 EC report appear to indicate that the compliance level as measured by published notices has now improved: the number of notices advertising contracts had almost doubled between 1995 and 2002 (whilst the size of the procurement markets involved has increased just by 30 per cent) (EC 2004, pp. 7–8). Unlike the 1997 study, the 2004 report does not, however, refer to the percentage of entities that publish advertisement. The 2004 report also indicates that the average value of public procurement covered by advertising notices was 16.2 per cent, with a figure of 21 per cent of the UK. However, this does not say anything about the precise level of compliance in each Member State because of the lack of data on the proportion of the markets that are subject to the directives publication requirement. As the report acknowledges, this is affected by various factors such as the degree of centralisation in purchasing (which itself affects the proportion of procurement falling above the thresholds). So far as award notices are concerned, the 2004 EC report indicates that the proportion of advertised contracts for which an award notice is published is about 50 per cent (EC 2004, p. 8) – a similar proportion to that found in the 1997 EC study (although of course, the number of award notices was higher in 2002 as the number of advertisements had increased).

The 1997 EC study also identified the procuring entities reluctance to adopt new technology as a factor inhibiting the success of the directives in the strategic product sector.

The 2004 EC report also provides some evidence on the extent of discrimination based on nationality, based on examining the success rates in bidding of a sample of more than 1 500 firms. This found that the success rate of foreign subsidiaries bidding in the country of location was in fact slightly higher than that of domestic firms (about 35 per cent to 30 per cent for domestic firms), but that the success rate of operators bidding from abroad was slightly lower (25 per cent). On this basis, the study concluded that public procurement markets are in fact "relatively open to competition". However, the report does not consider haw far this openness has increased, nor whether (if so) this is the result of the directives.

How far economic benefits result from the directives is also affected by the way in which firms respond to new cross-border opportunities: even if the practices of procuring entities do not operate as barriers to trade, the expected benefits will not be realised if the supply side does not respond in a competitive manner. The 1997 EC study revealed that only 30 per

[5] Whilst obviously the study did not assess the detailed application of the rules in all these compliance with the major requirements of the directivesaward procedures.

[6] A study of Dutch municipalities by Telgen and De Boer (2001) contained very similar findings.

[7] See, for example, Arrowsmith (1996).

cent of Small and Medium Sized Enterprises (SMEs) who are already suppliers to the public sector read the Official Journal. The study concluded that the lack of supplier awareness was one factor in the limited success of the rules. Further, participation may be inhibited by various factors including entrepreneurial skills or the lack of confidence that foreign firms will be fairly treated fairly (even if they are). Firms may also be deterred from participation by the high cost of competing in public markets. For example, requiring complete tenders that can be accepted or rejected without discussion, as is generally required when using the EC standard (open or restricted) procedures but not in many private sector tenders, adds greatly to costs. A study by the UK Treasury in 1999 found that bidding costs on public projects were typically 10–50 per cent higher that on the comparable private sector projects (Gershon 1999) and also that such high costs deter competitive firms. Paradoxically, the EC directives may add to these costs in certain Member States, and this is probably the case for the Czech Republic given the previously flexible nature of the Czech Republic public procurement system and the government policy of "commercialising" public procurement. The 1997 EC study found a consensus amongst procuring entities that the directives themselves had indeed increased administrative costs and in a study by the Charter Institute of Purchasing and Supply, 61 per cent of purchasers perceived that the EC legislation had increased their purchasing costs. The EC 2004 report also concluded, based on the comments of firms and authorities in two empirical studies, that transaction costs of public procurement were "significant" and needed to be reduced. The report also commented on the possibility that the new legislative package will reduce these costs. However, this is debatable, both because any greater flexibility that it provides is permissive, not mandatory, and may not be utilised in some Member States; and because the legislation itself is still unduly complex and rigid, as discussed below.

The impact of the EC rules may also be limited by the anti-competitive behaviour by the private sector. This could take the form of actual collusive tendering in public projects. Alternatively, it could occur simply through "understanding" on market sharing. If this happens, any efficiency savings may not occur or may not be passed on to purchasers. These problems may be exacerbated by the industrial restructuring induced by open procurement, which may itself create monopolies or oligopolies (Konstadakopoulos 1995). The EC directives themselves limit the ability of procuring entities to deal with collusive behaviour: this is more difficult to address in the formal tendering required for most public sector bodies by the directives than in negotiated procedures.

CONCLUSIONS

The 1997 EC study concluded that the failure of the supply side to respond in a competitive manner to new opportunities was a significant factor in limiting the success of the EU rules. For example, whilst in some sectors imports in public markets had increased, importers were sometimes not selling to other Member States at domestic prices but at the higher prices prevalent in the importing state. Often this was because main contractors were intermediaries who did not pass on savings that resulted from the use of cheaper foreign products. Whilst relevant for strategic products, this was a particularly important factor with commodity products, helping to explain why a greater import penetration did not necessarily translate into financial savings.

The 1997 EC study also identified technical incompatibility of national standards as an important reason for the limited success of the directives in some product areas – for example, with railway equipment and power distribution systems. The importance of this issue for Czech providers is also supported by the recent anecdotal evidence.

To improve economic profits and benefits in the area of public procurement, the European Commission is working on rules for electronic procurement which should be the way how to improve the European Single Market in the area of public procurement.

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Arrived on 11th May 2007

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