

The Cost of Different Goals

of

Public Procurement

The Cost of Different Goals of Public Procurement

Konkurrensverket
Swedish Competition Authority

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Swedish Competition Authority
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Preface

What should be the goal of public procurement? In view of the on-going reform of the procurement rules within the EU and Sweden the question is highly topical. It was on this theme that the Swedish Competition Authority arranged the conference *The Cost of Different Goals of Public Procurement*, in Stockholm with August 31 2011. The conference also marked the beginning of Sweden's presidency of the Public Procurement Network (PPN).

The Swedish Competition Authority invited leading international experts in the field of procurement to discuss the goals that ought to govern public procurement in the future, at a well attended conference with participants from 24 countries. The speakers brought different perspectives to the discussion, including economics, law and organizational theory as well as the inside perspective of centrally placed actors in the reform process. This volume contains background papers for four of the presentations at the conference and provides a good overview of the issues covered at the conference, although it cannot capture the lively and inspiring debate at the event itself.

I would like to express my sincere gratitude to the speakers, Steven Kelman, Giancarlo Spagnolo, Steven Tadelis, Sue Arrowsmith, Anders Wijkman and Klaus Wiedner, and of course the moderator of the conference, Sofia Lundberg who all contributed to making the conference such a stimulating event. I would also like to thank those at the Swedish Competition Authority who have worked with the project, Sten Nyberg who managed the project, Saba Zarrani, who assisted with the organization of the conference and Kristina Evensen who assisted in producing this conference volume.

Stockholm, November 2012

Dan Sjöblom
Director General

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The speakers

Below are brief presentations of the six speakers on the conference. The present volume collects papers relating to four of the talks, which is indicated by an * adjacent to the speaker's name.

Steven Kelman* is the Weatherhead Professor of Public Management at Harvard University's John F. Kennedy School of Government. A *summa cum laude* graduate of Harvard College, with a Ph.D. in government from Harvard University, he is the author of many books and articles on the policymaking process and on improving the management of government organizations. His latest book, *Unleashing Change: A Study of Organizational Change in Government*, was published in 2005 by the Brookings Institution Press. From 1993 through 1997, Steven Kelman served as Administrator of the Office of Federal Procurement Policy in the Office of Management and Budget. During his tenure as Administrator, he played a lead role in the Clinton Administration's "reinventing government" effort. He is a Fellow of the National Academy of Public Administration. In 2001, he received the Herbert Roback Memorial Award, the highest achievement award of the National Contract Management Association. In 2003 he was elected as a Director of The Procurement Roundtable, and he was inducted in 2007 into the *Government Computer News* Hall of Fame. In 2010 the American Political Science Association awarded him the Gaus Prize, which honors a lifetime of achievement in public administration scholarship. He currently serves as editor of the *International Public Management Journal*, and he writes a regular column for *Federal Computer Week* and a blog, *The Lectern*, at FCW.com.

Giancarlo Spagnolo* (M.Phil. Cambridge; Ph.D., Stockholm School of Economics) is Senior Research Fellow at *SITE - Stockholm School of Economics* and Professor of Economics (on leave) at *University of*

Rome II. He is also research affiliate of *CEPR*, and fellow of *EIEF* and *ENCORE*. He has previously been at the Departments of Economics of the Stockholm School of Economics and of the University of Mannheim and at the Research Division of the Sveriges Riksbank. In 2003 he founded the Research Unit of *Consip Spa* (the Italian central Procurement Agency) and run it for four years, supervising contract and tender design of hundreds of large procurements before going back to full-time academia. His main competences and interests are in Antitrust, Banking, Corporate Governance, Game and Contract Theory, Industrial Organization, eCommerce, and Procurement Design and Management. He has published widely quoted scientific articles in these fields and co-edited Cambridge University Press's *Handbook of Procurement* (under translation in Russian). He has also been consulting for many national and international institutions (including the World Bank, the EU Parliament and the EC DG Comp and EcFin) and private corporations, particularly on the design and management of procurement and reputational mechanisms. His main current research interests are in contractual and governance issues in large and dynamic procurement, reputation mechanism design and the procurement of innovation.

Sue Arrowsmith* is Achilles Professor of Public Procurement Law and Policy at the University of Nottingham, where she is also Director of the Public Procurement Research Group and of the School's postgraduate Executive programme in Public Procurement Law and Policy.

Her numerous publications have been extensively cited by courts and legislators in North America, Asia and Africa as well as Europe. Authored books include *The Law of Public and Utilities Procurement* (2nd ed 2005); (with Linarelli and Wallace) *Regulating Public Procurement; National and International perspectives* (2000); and *Government Procurement in the WTO* (Kluwer, 2003). In 1992 she launched the first international academic procurement journal, *Public Procurement Law Review*.

In 2007 she was awarded the CIPS Swinbank Medal for thought innovation in purchasing and supply. She has taught university modules on procurement since 1995 and from 2009-2011 was Project Leader of the EU-funded Asia Link project for developing a global academic network on procurement regulation, which included setting up the global Procurement Law Academic Network (PLAN – www.planpublicprocurement.org).

She has been a member since 1997 of the European Commission's independent Advisory Committee on public procurement; is a member of the UNCITRAL Experts Group on Procurement; and has been consultant and trainer for, inter alia, the UK Office of Government Commerce, UN, WTO, European Commission, OECD, EU, European Central Bank, ILO and Law Commission of England and Wales.

Anders Wijkman* Anders Wijkman is Senior Advisor to the Stockholm Environment Institute, to the department of Energy Systems at Linköping University and Board Member of the Tällberg Foundation. In a special assignment he is chairing a Swedish Government Task Force on a major review of Public Procurement legislation.

Anders was a Member of the European Parliament from 1999-2009, where his focus was on issues related to environment, energy and climate, development cooperation and humanitarian affairs. He received several awards during his years in Parliament, notably on his work on energy efficiency and renewable energy.

Prior to his election to the European Parliament, Anders served as Assistant Secretary-General of the United Nations and Policy Director of UNDP (1995-1997), Director-General of SAREC - Swedish Agency for Research Cooperation with Developing Countries - (1992-1994), Secretary-General of the Swedish Society for Nature Conservation (1989-1991) and Secretary General of the

Swedish Red Cross (1979-1988). He was also member of the Swedish Parliament from 1970 to 1978.

Anders is a member of the Club of Rome, the Swedish Royal Academy of Sciences and the Swedish Royal Academy of Agriculture and Forestry. He is also a Board member of the Stockholm Resilience Center, the International Environment Institute in Lund and SOLARUS, an innovative solar energy company.

Anders was appointed honoray doctor at Linköping University in 2011. He is the author of several books on sustainable development, HIV/Aids and European integration. His most recent book "The big denial" – with co-author Professor Johan Rockström – was published in april this year. Born in 1944, Anders is married and has three children.

Dr. Klaus Wiedner; studies of law in Graz/Austria and the College of Europe in Bruges/Belgium; 1993-1995 Austrian Ministry for Economic Affairs; since 1996 civil servant in the European Commission; 1996-2004 Member of the Legal Service of the European Commission competent in particular for competition and public procurement; 2004-2009 first Deputy Head, then Acting Head of the Unit in charge of defence procurement in the Public Procurement Directorate of DG MARKT; since October 2009 confirmed as Head of this Unit.

Steve Tadelis is a professor at UC Berkeley's Haas School of Business. His main fields of interest are the economics of incentives, contracts and organizations, and he has written research papers on such topics as a firm's reputation as a valuable, tradeable asset; public and private sector procurement and award mechanisms; outsourcing and the design of organizations; information disclosure in auction design; and some behavioral determinants of trust. He is currently on leave from Berkeley and is spending the year at eBay Research Labs in San Jose, CA.

1 Introduction

By Sten Nyberg

Public procurement rules govern a sizable share of the economic transactions in the interface between the public and private sector. Clearly, the design of the public procurement rules plays a key role in determining how well public procurement functions and is therefore an issue of great economic importance. An important point of departure for modernization and reform of public procurement regulation is the objectives of the regulation. Yet, judging from the public debate the objectives can encompass a fairly wide range of goals ranging from promoting competition to protecting the environment or ensuring fair labor market conditions. Therefore, the Swedish Competition Authority, which is also the supervisory body for the Swedish public procurement act, found the Cost of Different Goals of Public Procurement to be a both timely and highly relevant theme for a conference. Below is a very brief account of some of the points by the speakers. This book collects background papers for four of the six presentations held at the conference.

It is a widely held view that public procurement serves, or should serve, the purpose to provide taxpayers with the best value for their money. While public procurement can also be used to further other objectives, providing citizens with value for their tax money is an objective that all the speakers on the conference agreed should be center stage. However, there was also wide agreement that the current European procurement regulation does not measure up on this score. This is perhaps not so surprising in view of that the primary objective behind the current regulation has not been economic efficiency. In fact, both Sue Arrowsmith, who heads the Public Procurement Research Group at the University of Nottingham, and Giancarlo Spagnolo, with the Stockholm School of Economics, argued that a fundamental objective of the EU public

procurement rules has been to further the integration of the common market.

A reform of the European procurement regulation could potentially improve matters significantly. Indeed, Klaus Wiedner, from DG Internal Market and Services of the European Commission, emphasized that a very important objective for the modernization of the European public procurement rules is that public funds should be used effectively. He also discussed how the work with this modernization is progressing and the lessons learned from the consultative responses in connection with the Green Paper. However, several speakers articulated views on how the system of rules should be reformed that departed from the orientation indicated in the Green Paper issued by the European Commission. Arrowsmith also noted that while the objective market integration is supported by the Union Treaty, this is actually not the case as regards the goal of getting value for tax money, which is rather the concern of the Member States.

Steven Kelman, from the Kennedy School of Government at Harvard, discussed the interaction between rules, or restrictions, and goals, and the risk that placing far too great an emphasis on restrictions may be at the cost of achievement of goals. The safest way to avoid breaking any rules is to do nothing at all, which clearly defeats the purpose of procurement in the first place. Kelman discussed how to design rules so as to remind the user of the ultimate goal. Several speakers discussed the need for the rules to be a simplified. Spagnolo argued, referring to research results based on Italian data, that increased discretion for procurers normally improves effectiveness, despite the increased risk of corruption. He also emphasized the importance of the public procurement rules that allow for taking sellers' past performance into account, and showed that this need not make it more difficult for new businesses to participate in procurements.

Steve Tadelis, from UC Berkeley and e-Bay research labs, emphasized the importance of the public procurement rules functioning for complex procurements where, typically, it is necessary to modify a contract several times during the term of the contract. Central issues therefore include the scope for negotiation between the parties, the possibility of taking into account the provider's past performance and follow-up of the contract. Tadelis was doubtful as to why the current orientation of the Green Paper is to only allow negotiations in exceptional cases. Kelman noted earlier that the American system of rules is unfortunately also restrictive in this respect. He also emphasized the importance of follow-up. Both follow-ups and ex-post evaluations require information, and several speakers that such information should be collected and made available to researchers.

Anders Wijkman, who leads the Swedish Committee of Inquiry on Public Procurement, observed that improved procurement statistics comprise an important part of the mandate of the Committee. He also provided a picture of the work of the Committee and its priorities, and referred to several of the trains of thought that had been touched on earlier during the day. He also emphasized the issue of resources and competence on the part of contracting authorities.

The present volume contains the contributions by Steven Kelman, Giancarlo Spagnolo, Sue Arrowsmith and Anders Wijkman.

2 Goals, Constraints, and the Design of a Public Procurement System

*By Steven Kelman**

2.1 Introduction

This presentation will be in three parts: (1) A theoretical perspective to guide the design of a procurement system. I study and do research on management and on organizations in general, and my perspective on procurement system design is influenced by that. In particular, I will focus on the roles of rules in organizations in general (2) some more specifics about application of these general ideas to design of procurement system in particular (3) a discussion of the procurement reforms of 1990's in the U.S., in which I participated.

2.2 Considerations in the design of a procurement system

Any organization has both goals it seeks and constraints it must not violate. A private company – say ibm – has the goal of maximizing profits for its shareholders. But it also operates under constraints. It may not despoil the environment. It may not commit accounting fraud. It may not kidnap competitors.

Similarly, a procurement system has both goals it seeks and constraints it must not violate. Its goal – to use American language, is

* Professor of Public Management, Kennedy School of Government, Harvard University.

attaining best-value products¹ and services on behalf of agency missions and of taxpayers. The procurement system's constraints include avoiding corruption and nepotism, treating vendors fairly, and being transparent.

Which is more important, goals or constraints? On the one hand, clearly both are important. However, it should be noted that a successful organization cannot be one that only respects constraints, without achieving its goals. One observation that should make this obvious is that it would be possible for a procurement organization completely to respect the constraints under which it operates by not buying anything! If it didn't buy anything, it could not display corruption, nepotism, unfair treatment of vendors, or lack of transparency. Examples of the same phenomena exist in other areas of activity as well. A journalist who recounts that he or she has never compromised a source or written an untruth – but who also never had broken a story – would not be considered a successful journalist. Nor would a politician who never took a bribe nor lied to constituents, but never sponsored any legislation or performed oversight of a government agency.

Second, if a person needs to spend significant time and/or psychic energy thinking about not violating constraints, that person is unlikely to have energy left to work on achieving his or her goals. Imagine the individual who needs to wake up every morning and think about “how will I avoid killing someone today?” Or “how will I avoid taking a bribe today?” Instead, the aim is for the constraints to be so much a part of the culture of an organization that people don't need to spend any time thinking about them. We normally don't even think of the injunction that a firm may not kidnap competitors as a constraint on the behavior of IBM because IBM is unlikely to imagine kidnapping competitors.

¹ In the U.K., often called “value for money.”

Third, relative attention to goals and constraints should vary depending on the administrative culture and capacity of the country. What are called “contingency theories” are common in management research. We would never say that supervisors should apply the same management practices for recently arrived peasants in a factory producing sneakers and for PhD’s in a research lab. In the U.S. We don’t need to worry about companies kidnapping competitors; in Russia in the 1990’s, there was cause for concern. It makes no more sense to suggest that the same importance be given to goals and constraints – or to ways to design a procurement system to promote these – in Paraguay versus in Sweden than it does to manage peasant-worker in a shoe factory and the PhD the same way.

Despite all the above, there is a natural pressure in procurement systems to emphasize constraints over goals. This is so for several reasons:

- (1) Path dependence²: Corruption was once an overwhelming problem in most procurement systems in most countries. The procurement system became designed around minimizing corruption. However, now the emphasis remains, even though in many countries, corruption is now only a small problem for procurement systems.

² “Path dependence” refers to a situation where a practice initially gets established for one set of reasons – or even just coincidentally – but where, once established, the practice takes root and becomes difficult to change even if it is no longer appropriate under new circumstance (or if there was no strong reason for its initial adoption). The concept was first discussed in the context of the persistence of the inefficient “QWERTY” configuration of typing systems; this was initially developed explicitly to slow down typing speed, because early typewriters would jam if people typed too fast; because of investments in learning the configuration, it persisted, despite its inefficiency, after the constraint of typewriter speed vanished.

- (2) “Everybody can agree” on constraints, while substantive issues of goals are often more politically controversial. We see this most dramatically in the general political process, where people can easily agree politicians should take bribes or lie, but substantive political issues – what should tax rates be, what should government do (or not) to promote economic growth – are highly controversial.
- (3) The operation of a procurement system is highly technical – and very boring. By contrast, it is much easier for people to understand scandals.

However, if the above analysis about goals and constraints is correct, then what the system designer should seek to do is to remind the system – so to speak – of the importance of its goals, to create as much room as possible in the system for the pursuit of goal fulfillment. In this situation, what are the implications for the role and nature of rules in the system?

- (1) Rules are good for indicating constraints, for telling people what they must do or must avoid. (In this regard, we may note that rules are a kind of law, and that law is a system of constraints.) But there are other ways to promote respect for constraints – such as organizational culture, training, or criminal prosecution. We often create rules, whose purpose is to promote respect for constraints, that create problems for the 99.9% of people who are honest, as well as for the ability of the system to meet its goals – when we could be using other techniques to promote respect for constraints.
- (2) Often (though to be sure not always) rules seeking to promote respect for constraints can and should be expressed as “you shall not.” This is good. It makes rules less onerous, because they involve negative duties,

i.e. Duties you can fulfill simply by avoiding action. (It is very easy to fulfill a duty not to murder people, even if it applies to billions of human beings.) Thus one policy recommendation for the role of rules in a procurement system is to try to make rules aimed at respecting constraints “you shall not” as much as possible.

- (3) One way to see rules in the above framework is to see them, to use the expression of professor Robert Simons, as “boundary systems” that establish limits for discretion. Professor Simons’ idea is that inside the boundary, people should be given as much discretion as possible to figure out the best way to achieve the organization’s goals. The rules establish limits outside which employees are not allowed to go. Thus rules function somewhat like the electric fences for dogs popular in the us, that allow the dog to roam freely inside the fence, but not to wander outside.
- (4) Rules don’t only have a constraint-promotion function. They also can be used to share knowledge about practices that, based on past experience or research, generally produce good results. We don’t say to an F-16 airplane pilot that, just because they are smart and well-trained, they should figure out for themselves how to fly this complex airplane. To take another military example, we allow soldiers without a university degree to maintain very complex and expensive military aircraft, because we give them a set of procedures about how to do this properly. In the procurement system, the basic principle of competition would be an example of a rule that reflects accumulated knowledge about what kinds of practices generally produce good results in terms of the goals of the system. It has sometimes been noted that, when some of the rules in the procurement system were taken away, staff went back to old rule book to figure out what to do.

Some of the rules were in these cases helping them do their jobs better. (When I ask my 25 year-old students about whether the jobs they had prior to returning to university had too many, too few, or the right number of rules, as many say “too few” as “too many,” though to be sure among those who had worked in government, the majority say too many!)

However, the use of rules to impart knowledge that can promote the procurement system’s goal of best value can also be problematic:

- (1) The most obvious is that the rule doesn’t always apply to all situations. Competition is generally good for the procurement system, but sometimes it might help the system to reward a well-performing contractor by extending a contract, or to have longer-term contracts rather than constant spot-market rebidding. If the argument for rules to spread knowledge is reflected in the aphorism, “don’t reinvent the wheel,” this worry about rules is reflected with the aphorism, “one size doesn’t fit all.”
- (2) The presence of many rules cumulatively slows the system down, creating slow procurement cycle times. This contradicts the message we want to give program managers that their missions are important, and require hard work and a sense of urgency on their part. A slow procurement system promotes a satisfaction with performance mediocrity, a kind of “good enough for government work” mentality.
- (3) Perhaps the least obvious but most important problem with rules is one noted by professor Henry Mintzberg. Rules are designed to reflect a minimum standard that everyone must attain. However, in a rule-bound

organizational environment, it is very easy for employees to get the message that their entire job consists of obeying the rules, and that they need do nothing additional. Thus, Mintzberg argues, the minimum becomes the maximum. (I had an experience with this problem on entering us government service in 1993. Shortly after arriving, I discovered that almost all government organizations were buying off-the-shelf software in single, “shrink wrapped” packages rather than – as even at that time was the common practice in large American corporations – purchasing much-less expensive site licences for employee access to the software. In trying to determine how this had occurred, I soon realized that nobody had violated any rules. The individual software boxes had been bid out and subjected to strong competition; the government probably got the lowest price anywhere for individual shrink-wrapped software. The problem was that nobody had thought to go beyond the rules and inquire whether the business practice of buying software this way made sense.)

- (4) Finally, in a very rule-bounded environment, it is hard to attract and retain a young workforce that, generally, seeks more autonomy. This will be an increasing problem for rule-bound organizations in government, including procurement organizations, as a generational transfer in the workforce takes place.

This discussion suggests a second principle for design of a procurement system: if the purpose of a rule is to impart knowledge, give the rule the form of suggestion, advice, or guidance, not a binding requirement. If the rule is designed to help employees, have it be available for those who want the help. Make the rule enabling, not coercive.

2.3 The procurement reforms of 1990's in the U.S.

The reforms in the U.S. procurement system during the 1990's? – undertaken as part of the “reinventing government” efforts of the Clinton administration³ – basically took the approach outlined here.

At a strategic level, a strong effort was made to nudge the system to weight goals more than previously, constraints less than previously. Part of this effort involved an important change to part 1 of the federal acquisition regulation. The new language adopted the goals/constraints distinction, as well as the idea that binding rules were as much as possible prohibitions against things one was not allowed to do rather than requirements to do certain things. In particular, the “guiding principles” (FAR 1.101-2) added to the regulations stated:

“the vision for the federal acquisition system is to deliver on a timely basis the best value product or service to the customer, while maintaining the public’s trust and fulfilling public policy objectives.”

and:

“in exercising initiative, government members of the acquisition team may assume if a specific strategy, practice, policy or procedure is in the best interests of the government and is not addressed in the far, nor prohibited by law (statute or case law), executive order or other regulation, that the strategy, practice, policy or procedure is a permissible exercise of authority.”

- (1) An effort was made to encourage front-line people in the system to develop new ways to buy. A number of changes became introduced into the system, not through

³ These were an American adaptation of ideas of what in Europe is often called the so-called “new public management.”

regulation or central initiative, but based on ideas developed by people inside the system. These included oral presentations (situations where the actual people who would be leading a contractor's effort answered questions in real time from program and contracting officials, to get more information about their talents and ideas), due diligence (an opportunity for competitors, before preparing their bids, to spend time in the agency's facilities to learn more about their business processes and interview people inside the agency working on the business processes, blanket purchase agreements (contracts written with a governmentwide umbrella contract as a base, where an agency would get better prices or other terms in exchange for a purchase commitment to a vendor), and reverse auctions.

- (2) Significant streamlining occurred to allow the system to work more quickly. Some rules were eliminated, particularly for purchases of off-the-shelf items. Credit cards were introduced for so-called "micro purchases" under \$2500, which allowed program people to buy directly without needing to go through a contracting office.
- (3) Various steps were undertaken to increase the ability of the system to obtain best value from contactors. Consideration of vendor past performance were introduced into the system for the first time, making it much easier and more-legitimate to reward well-performing suppliers. Greater emphasis was placed on earlier initiatives to encourage performance-based service contracting (using performance standards for contractors rather than specifying how the work was to be done) and market research (learning more during the acquisition planning phase of the process about what the market had to offer and how others, particularly

commercial buyers, were buying the products or services the government was planning to buy).

- (4) There were different views inside the procurement system for why the streamlining initiatives were undertaken. Some in the procurement workforce favored streamlining simply as a way to reduce their own workload (and probably as well to reduce complaints from those on whose behalf they were buying about how slow the system was). In my own view as leader of the effort, however, the main reasons were two. First, to spread a message to program officials about the urgency and importance of their missions, which required urgency in obtaining for them the products and services they needed to perform those missions. Second, to free up time during the source-selection stage of the procurement process that could then be redirected into acquisition strategy prior to source selection (market research, figuring out the most-appropriate form of contract, developing performance measures) and contract management after the contract was signed, to increase the chance that the selected contractor would actually deliver.

Since the 1990's, many of the specific reforms introduced during that period have remained in place. However, pressures in the system to emphasize on constraints didn't disappear. The politicization of contracting in connection with the iraq war – where domestic U.S. Opponents of the war in congress sought to use real or alleged procurement “scandals” and/or competition problems – led to a situation where fear re-emerged inside the system among civil servants working on contracting. Some rule violations (involving competition requirements and compliance of procurement spending with appropriations law) also contributed to a climate of caution during the first decade of the 1990's. Together, these problems

produced the disappearance of the spirit of innovation that had characterized the 1990's.

During the Obama administration, there has been something of a move back towards promoting innovation – probably the biggest example has been the promotion of contests as a procurement technique (where the government puts out a requirement and offers a specific prize for those who first solve the problem, so the government pays only for success). The tight budget situation is also encouraging innovations in terms of “strategic sourcing” (leveraging the government’s buying power), new contracting forms such as “share-in-savings” contracting (where a contractor is paid all or in part in the form of a percentage of cost savings their efforts generate), and other ways to save money. In all, however, one may say that the tension between emphasizing goals and constraints in design of the procurement system remains.

Appendix: Except from Federal acquisition regulation

1.102-2 performance standards

- (a) satisfy the customer in terms of cost, quality, and timeliness of the delivered product or service.
 - (1) the principal customers for the product or service provided by the system are the users and line managers, acting on behalf of the american taxpayer.
 - (2) the system must be responsive and adaptive to customer needs, concerns, and feedback. Implementation of acquisition policies and procedures, as well as consideration of timeliness, quality, and cost throughout the process, must take into account the perspective of the user of the product or service.
 - (3) when selecting contractors to provide products or perform services, the government will use contractors who have a track record of successful past performance or who demonstrate a current superior ability to perform.

- (4) the government must not hesitate to communicate with the commercial sector as early as possible in the acquisition cycle to help the government determine the capabilities available in the commercial marketplace. The government will maximize its use of commercial products and services in meeting government requirements.
 - (5) it is the policy of the system to promote competition in the acquisition process.
 - (6) the system must perform in a timely, high quality, and cost-effective manner.
 - (7) all members of the team are required to employ planning as an integral part of the overall process of acquiring products or services. Although advance planning is required, each member of the team must be flexible in order to accommodate changing or unforeseen mission needs. Planning is a tool for the accomplishment of tasks, and application of its discipline should be commensurate with the size and nature of a given task.
- (b) minimize administrative operating costs.

3 Public Procurement as a Policy Tool

*By Giancarlo Spagnolo**

3.1 Introduction

Public procurement regulation is currently under review in Europe. Many call for a more active use of public procurement as a policy tool to stimulate innovation, green technologies and social inclusion. This would require more flexible procurement instruments and ex-post monitoring of outcomes to limit their abuse. Other policy objectives, public accountability and European market integration, have led instead to a public procurement regulation that constrains the use of flexible procedures and controls ex-ante procedures rather than ex-post performance. Since 1994 the US has gone in the opposite direction, increasing flexibility and encouraging the collection of ex-post performance assessments and their use as contractor selection criteria. This note discusses the limits of the current ex-ante approach in the EU and the complementary need for more flexibility, ex-post outcomes/performance data collection, and ex-post monitoring through reputational mechanisms. It also presents some new (preliminary) evidence on the likely costs of not allowing buyers to use reputation indicators based on past performance, and (preliminary) results from an experiment showing that reputational mechanisms can be designed to stimulate rather than hindering cross-border procurement and European market integration.

In times of tight budgets, efficiency of Public Procurement – accounting for over 15% of GDP in most countries – has become an important priority. In the debate around the current revision of the EU Procurement Directives, however, many are pushing for an

* Professor, SITE - Stockholm, University of Rome II, EIEF & CEPR.

increased use of Public Procurement as an active policy tool to stimulate innovation, green technologies, and social inclusion through SMEs participation (See the recent EU Green Paper and the Replies from the Consultation).

Shall we use Public Procurement (PP) to stimulate innovation, protect the environment, increase social inclusion, etc.? Critical observers, among which often the European Commission (See again the Green Paper), rightly warn that PP already has its own important objectives so that distorting it to achieve additional objectives may be too costly in terms of efficiency and value-for-money for the taxpayer. There are other instruments – the argument goes - that can be used for these other objectives, including taxes, subsidies and IPRs.

But what are the existing objectives of PP? Of course there are the two 'natural' objectives of obtaining good value-for-money for the taxpayer/citizen/user in the private provision of public goods & services, and of achieving an efficient allocation of production (choosing the most efficient suppliers as contractor). Other commonly mentioned objectives, sometimes seen as final objectives and sometimes as instrumental ones to achieve the two natural ones above, include maintaining accountability (avoiding corruption), promoting equal access to all eligible bidders, increasing transparency and favoring competition.

In Europe, however, PP regulation has been mainly developed pursuing the objective of increasing cross-border procurement *per se*, not as an instrument to obtain efficiency or value for money. Because of the political value of European common market integration in light of the last world wars, PP has already been intensively used as a policy tool in Europe to achieve more intense cross-border exchanges and market integration.

The EU Procurement Directives are indeed aimed at coordinating national public procurement regulations with the objective of fostering cross-border procurement transactions and European market integration, which not always coincide with

maximizing efficiency or value for money for the taxpayer. This approach may therefore imply costs in terms of value for money for the taxpayer and efficiency of the allocation. The most important ways by which the Procurement Directives pursue the political objective of common market integration are: i) increasing procedural rigidity in favor of well advertised open auctions; and ii) forbidding the use of past-performance based reputational indicators as selection criteria. In an imperfect contracting world as the one we live into, these may have implied substantial costs in terms of value for money and efficiency.

While European market integration is an important policy objective, it is not clear that it should be the main or only policy objective public procurement regulation should pursue, nor that the costs of the distortions to achieve this objective are justified by the benefits they generate. What are the opportunity costs and benefits of using PP regulation as a policy tool to pursue this political objective, where other tools could in principle have been used (taxes, subsidies, etc.), is not clearer than in the case of the other above-mentioned objectives (innovation, green technology etc.).

Note that one costs of using PP to foster common market integration is precisely that it limits the possibility to use PP to achieve other goals. The main obstacle for this use in Europe is precisely the high procedural rigidity of the current regulation, which favors open auctions even when they are clearly inappropriate to ensure access to public procurement contracts to potential foreign suppliers. Pursuing common market integration by trying to facilitate cross-border procurement has led to a regulation that pushes for open procedures that facilitate foreign firms participation but that make it very difficult to pay attention to long-term relationships, quality and trust, local specificity, innovative technologies, small firms inclusion, etc.

A more active use of PP as a policy tool to stimulate innovation, green technologies and social inclusion requires flexible procurement policies, and these require ex-post monitoring of outcomes to limit

accountability problems. Accountability and market integration concerns led instead to a European regulation that constrains the use of flexible procedures and focuses on ex-ante rules and procedures rather than ex-post (past) performance measurement.

Note that since 1994 the US has been going precisely in the opposite direction. Recognizing that excessive procedural rigidity may cause large inefficiencies and limited accountability gains, Kelman pushed for a deep reform of the US system when he was the head of public procurement, during the Clinton administration. The reform pointed at reducing the rigidity of procurement procedures built in the Federal Acquisition Regulations to enable public buyers to use more flexible purchasing methods similar to private sector practices.¹ This included an increased consideration of contractors' past performance, which is a central element of private procurement. Indeed, since the Federal Acquisitions Streamlining Act in 1994 US Federal Departments and Agencies are expected to record past contractors' performance evaluations and share them through common platforms for use in future contractor selection.

In the EU instead the rule remains that past performance information on suppliers can only be used to admit (disqualify) bidders to procurement processes, but not to discriminate among the bids submitted by the different contractors. This rule makes it hard for reputational forces to act and reward quality ex-post. It has been

¹ As in the case of independent central banks, maintaining accountability after an increase in public buyers' ex-ante discretion (independence) requires more stringent ex-post controls in terms of performance measurement and evaluation. A real of perceived lack of stronger ex-post performance controls may be at the root of recent concerns that this process may have led to excessive discretion and poor accountability in US public procurement (e.g. Yukins 2008).

one of the features under broader attack during the recent consultation for the revision of the EU Directives.²

The debate on public procurement regulation is particularly intense in Europe at the moment, where the revision of the, which coordinate public procurement in all EU countries, is taking place. However, there is a lively debate also in the US, in particular on how much discretion should be left to public buyers in the attempt to reduce transaction costs (see e.g. Yukins 2008). Also, a recent inquiry by the US General Audit Office (GAO) has just tried to verify whether the use of reputational indicators based on past performance in contractors selection allowed for and encouraged by the Federal Acquisition Regulations effectively reduced the ability of new contractors to enter the public construction market.³

But what do we actually know about the costs and benefits of using PP as a policy tool to foster European market integration, or to stimulate innovation and green technologies? How do we know that PP it is more or less costly than using other instruments? Indeed, we don't know. For the most part, this is a dataless debate. True, economic research is lagging behind the policy debate on these issues, as most academic researchers appear not interested or aware of it. But the lack of robust knowledge on the costs and benefits of different policies is also due to the absence of available data that would allow researchers to quantify the relative efficiency of different policies. Even those data that are collected by procurement agencies and their watchdogs, including the European Commission, they are often only made available to paid-for evaluators that are

² See the summary of the replies to the consultation at http://ec.europa.eu/internal_market/consultations/docs/2011/public_procurement/synthesis_document_en.pdf.

³ See GAO-12-102R, October 18, 2011. The relationship between reputation and entry will be a central theme of this essay.

typically not very objective nor terribly competent.⁴ Moreover, even when existing and robust research findings are present, they are typically not taken into account by the lawmakers that are reforming procurement rules around the world, with the very poor results in terms of quality of regulation that we all see.⁵

In this paper I summarize preliminary results from some recent work of mine with several co-authors that may give an idea of the limits and the costs of the current ex-ante approach to accountability and market integration in Europe. I discuss the complementary need for discretion, selective competition and ex-post data collection to

⁴ See the last evaluations of the European Procurement Directives commissioned by the European Commission for an example of both problems. The Commission should spend money to put its data on-line in a machine-readable way, so that capable and independent researchers could perform serious policy impact studies (for free), rather than paying mediocre consulting companies to use the data to say what it wants to hear.

⁵ The drafting of public procurement regulation in Europe appears entirely driven by procurement practice and legal tradition. It seems totally unable (or uninterested) in taking into account even the most basic economic efficiency principles. An example that I often quote is that of framework agreements, a two-stage procurement mechanism where the public buyer can competitively pre-select a number of suppliers from which regularly source in the following years without the cumbersome bureaucratic requirements of open auctions. The EU 2004 Directives admit that either one supplier is pre-selected, who would then act as a monopolist supplier w.r.t. the buying administration(s), or more than three, so that they may be asked to compete again when new demand materializes. Pre-selecting *two* suppliers in framework agreements is therefore not allowed in Europe. It is rather depressing to contrast this with the many studies that highlight that exactly *dual* and *second* sourcing – having two suppliers, is often the most efficient procurement strategy given that it can generate post-award competition and supply risk reduction while minimizing duplication of fixed costs.

reinforce at the same time flexibility in complex procurement processes (e.g. more use of the Competitive Dialogue), necessary to foster innovation, and the ex-post performance monitoring through reputational mechanisms. I then present some new (preliminary) evidence on the likely costs of not allowing buyers to use reputation indicators based on past performance; and preliminary results from an experiment showing that reputational mechanisms can be designed to stimulate cross-border procurement and market integration.

3.2 Reputation and Quality in Procurement: Suggestive Evidence from a Recent Experiment

We noted that while the US has been emphasizing more and more the importance of collecting, sharing and using past performance evaluations for selecting federal contractors, the European Commission through its various Directives has been moving in the opposite direction, making it more difficult to use reputational indicators to select public contractors. Many complain for a perceived loss of quality caused by a regulation imposing equal treatment for sometimes very different bidders. Not considering differences in past performance clearly favours poor suppliers, possibly lowering final quality and value for money even if prices fall. But are these costs large? What do we lose by not allowing reputation to work in the EU?

To appreciate the extent to which reputational forces may improve procurement outcomes I briefly describe the preliminary results from an experiment we carried out in Italy, documented in Pacini and Spagnolo (2011). The experiment - unfortunately not a randomized one, the firm for which we worked did not allow it - suggests that reputational incentives may be very strong, able to greatly influence suppliers' behaviour already after a first generic

announcement that past performance measures will be collected and used in the future for selection purposes.

The experiment relates to the introduction of a vendor rating system by one of the largest public multi-utility companies listed on the Italian exchange. The firm operates in the sale and distribution of energy, water services and public lighting. In order to maintain an orderly functioning of its power grid, each year the firm outsources works worth over 300 million euro. Since this firm is controlled by a public administration, it has to apply the Italian Code of Public Contracts when selecting contractors and awarding contracts.⁶

Being a multi-utilities company, this firm falls in the “special sectors” which enjoy some flexibility in applying the Code. Starting from the second semester of 2007, it introduced a system of vendor rating for suppliers with the plan to use its ratings at the awarding stage. The plan to introduce such a mechanism was announced to contractors, gradually disclosing details on its functioning and timing, along 5 main announcement events: the 20th December 2007, the 4th April 2008, the 10th July 2008, the 21st October 2008 and the 16th January 2009.

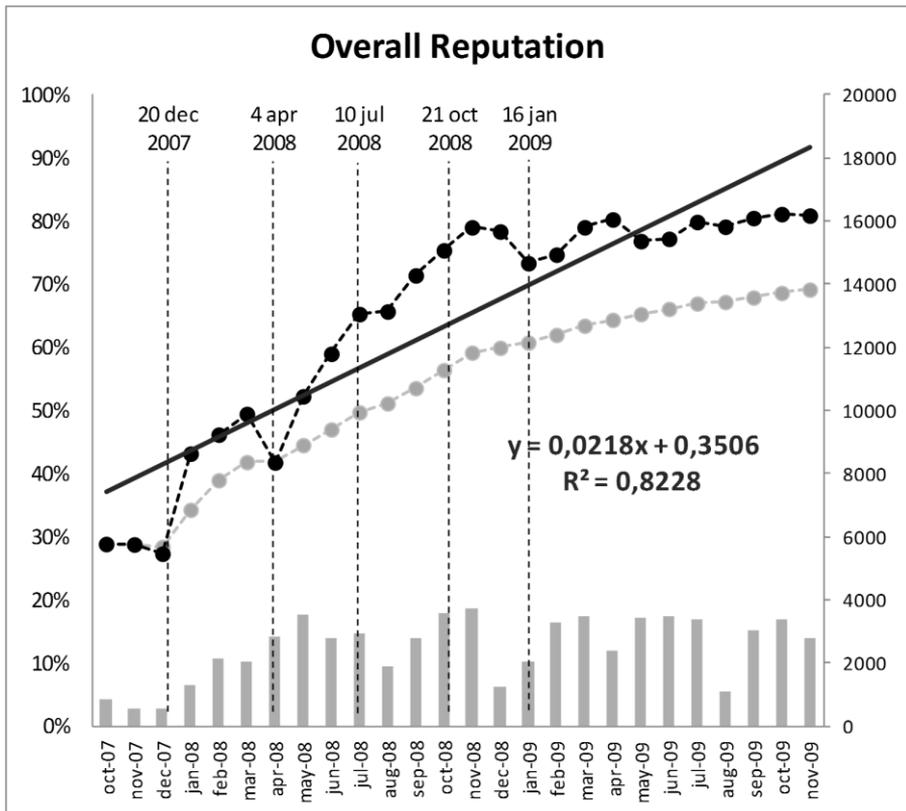
The vendor rating score was a weighted average of 134 criteria linked to the stringent quality and safety regulation of this industry. These parameters were collected by a team of (rotating) auditors in a number on-site visits. Auditors attributed a score to each parameter inspected and the set of parameters is divided into two macro-classes, Safety (51) and Quality (83), further sub-grouped according to 12 Safety and Quality dimensions (7 for Safety and 5 for Quality).

We had access to the results of inspections in the period between the 16th October 2007 and the 19th November 2009 across 45 different contractors, 222 contracts and 1,952 works sites and of a sample of 120 corresponding tenders. We carried out three simple statistical

⁶ The Code is the law that has implemented the European Union public procurement directives 17/2004 and 18/2004.

tests: i) a series of t-test on the 5 announcements relating the introduction of the vendor rating in the awarding phase on the reputation score and auction discount time series; ii) a probit estimation on the single parameters scores; and iii) the correlation between reputation score and auction discounts.

Figure 1



The black dotted line shows the average score calculated on all parameters inspected in the month of reference. The black dotted line shows the average score calculated on all parameters inspected in the month of reference. The grey dotted line shows the cumulated average score calculated on all parameters inspected until month of reference. The full straight line is the trend calculated out of the black dotted line. The bars indicate the total number of parameters checked throughout the month of reference. The vertical dashed line identifies each announcement date.

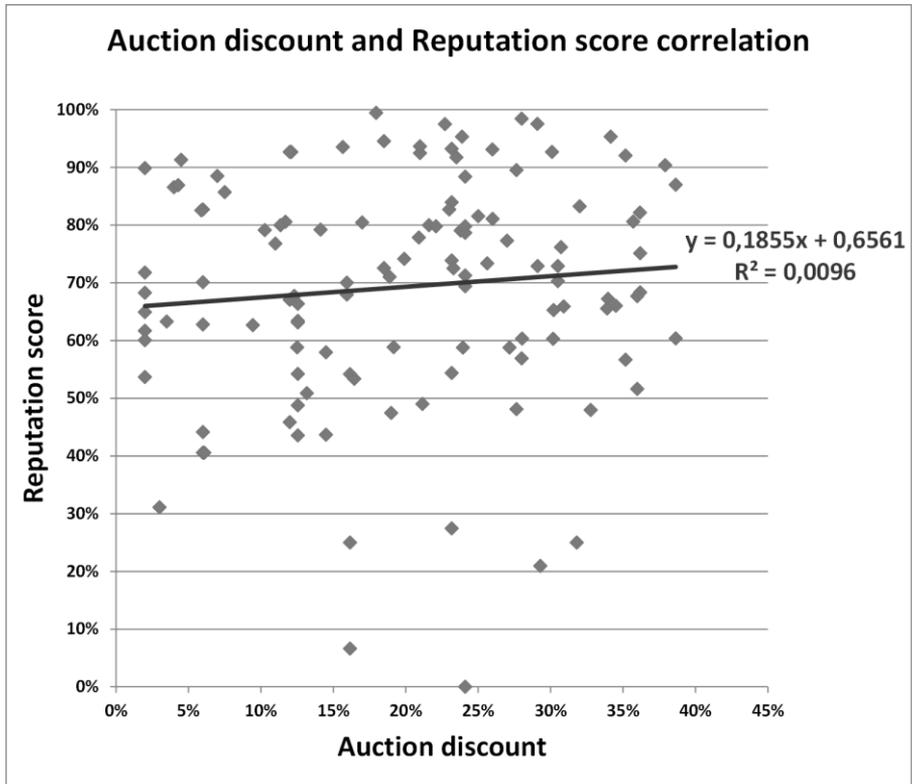
Table 1

T-test					
	<i>Announcements</i>				
	1st 20 dec 07	2nd 4 apr 08	3rd 10 jul 08	4th 21 oct 08	5th 16 jan 09
Overall	-	-	-	-	-
<i>Main Dimensions</i>					
Safety (S)	-	-	-	-	-
Quality (Q)	-	-	-	-	-
<i>Specific Safety and Quality Dimensions</i>					
S - Equipment and machinery	-	-	-	-	-
S - Documentation	-	-	-	-	-
S - Works execution	-	-	-	-	-
Q - Works on joints	+	0	-	-	-
Q - Customer relationship management	+	+	-	-	-
Q - Air works	n.a.	-	-	0	0
Q - Underground works	-	-	-	-	-
Q - Transformer station works	0	0	0	0	0
S - Personnel	-	-	-	-	-
S - Works site regularity	-	-	-	-	-
S - Works site safety	-	-	-	-	-
S - Works site controls	n.a.	n.a.	n.a.	0	0
<i>Most awarded and audited firms</i>					
AC	-	-	-	-	-
AF	-	-	-	-	-
AI	-	-	-	-	-
AL	-	0	-	-	-
D	-	-	-	-	-
G	-	-	-	-	-
L	n.a.	-	-	-	-
M	-	-	-	-	-
U	-	-	-	-	-

-/+ = score before the announcement is significantly (5%) lower/higher than after. 0 = score not significantly different. n.a. = not available. Each test is run between the group of all parameters inspected before the specific announcement and the group of all parameters inspected after the specific announcement, for each category in each row.

The results show a very strong and significant increase in quality/safety starting after the first announcement (see Figure 1, Overall Reputation). Significant jumps (structural breaks) take also place at the other announcements reviewing the collected individual performance indicators and giving further information on the development of the project.

Figure 2



Each dot identifies one contract to which is associated the discount offered by the winning firm (on the x-axis) at the auction where the contract was awarded and the score calculated on all parameters inspected throughout the same contract life (on the y-axis). The line is the linear regression line calculated out of the 120 auction discount/reputational score combinations, where the reputational score is the dependent variable and the auction discount is the independent variable. The auction regression coefficient, 0.1855, is not statistically significant (p value = 0.29).

On the other hand, no structural breaks are observed in winning discounts/prices (see Figure 2): it appears that there is no correlation between discounts/prices and quality/safety of works. Apparently, the strong increase in quality and safety has come as a (almost) free lunch to this firm.

3.3 Restricted vs. Open Auctions in Procurement: Preliminary Empirical Evidence

Recent theoretical work by Calzolari and Spagnolo's (2009) highlights the complementary but roles of buyer's discretion and of restricted competition in eliciting non-contractible quality through long-term relationships. In Coviello, Guglielmo and Spagnolo (2011) we try to quantify the causal effects of the increased discretion and reduced competition linked to the use of restricted auctions in public procurement. We analyse a large database of Italian public construction procurements to estimate the causal effect of the use of restricted rather than open auctions on both ex-ante (number of bids, awarding price) and ex-post outcomes (completion time, cost overrun). The latter outcomes are in principle contractible, but regulatory limits to penalties for contract violations and high contract enforcement costs severely limit the scope for contractual governance. Moreover, cost overrun still creates problems to buyers who may then prefer contractors that do not incur in them too frequently. We also try to identify the presence and effects of repeated procurement relationships sustained by the higher discretion left to public buyers when they are allowed to use restricted auctions.

We collect data on a large sample of procurements for public works in Italy for the years 2000-2005, with the characteristic that the award mechanism discretely changes across them. Procurements are assigned by law to an award mechanism on the basis of the reserve price of the procurement project, which should be rigidly based on engineering estimates of the costs of completion performed according to codified criteria. Procurements with reserve price/estimated value below an exogenous threshold can be awarded with a restricted auction where a minimum of 15 suppliers are invited, while those above threshold must be awarded with an open auction. A Regression Discontinuity Design (RDD) can then be used to compare auctions with reserve prices immediately above or below

the discontinuity. Absent sorting/bunching around the threshold, these two groups of procurements have different awarding mechanisms but should otherwise be identical in terms of observable and unobservable characteristics determining the outcomes of interest.

We first look at the effects on ex-ante variables like number of bidders, entry and the winning rebate. We find that restricted auctions mildly reduce the number of bids but do not have any significant effect on the winning rebate. This is likely due to the legal constraint that requires at least 15 bidders to be invited in a restricted auction. It may be ensuring that although they allow for discretion - in the sense of opening the possibility of excluding (not inviting) a given bidder - restricted auctions do not significantly reduce competition.⁷

We then look at the effects on ex-post outcome variables related to the efficiency in contract execution. We focus mainly on work length and cost overrun. We find that the use of restricted auctions does not significantly affect cost overrun or completion time, but leads to larger limitedly liable firms winning more often. Since limitedly liable firms are the largest, it appears that contracting authorities choose larger firms when they can, thanks to the use of restricted auctions.

We next study the effect of the awarding mechanism on the winning probability of incumbents, i.e. suppliers that already served that buyer in the recent past (defined in different ways). We find that relative to restricted auctions, the use of open auctions reduces the probability (frequency) of awarding the contract to a previous winner by 83% (one interaction). It appears therefore that open auctions considerably limit long-term relationships between

⁷ Indeed the average number of bidders with open auctions is similar to the minimum number of invited bidders in the restricted one, so that with costly bidding the invitation may be playing the role of a coordination device for participation.

contracting authority and firms, whether aimed at improving quality or at sustaining corruption.

These are preliminary results that need to be checked for robustness to several possible problems. Still, they seem to suggest that, at least in the Italian public construction sector, the use of restricted auctions may have improved ex post outcomes (completion time) by unleashing buyers' discretion without reducing competition but limiting the entry of suppliers coming from other areas. They also seem to square well with Bandiera et al.'s (2009) finding that public bodies with more autonomy/discretion were not more corrupt but were significantly more efficient in procuring public goods and services in Italy during about the same period.

3.4 Reputation and Entry

Let me now turn to the folk wisdom among European regulators that the use of reputational indicators based on past performance as criteria for selecting contractors would hinder entry of new suppliers, cross-border procurement and thereby the policy objective of European market integration. This concern, that reputation-based selection criteria may limit entry of new suppliers in procurement markets is apparently shared across the ocean, although for somewhat different reasons. As mentioned in the introduction, on October 18, 2011 the US General Accountability Office published the results of its inquiry on Federal agencies' use of past performance information for contractors selection, in reply to US Senators asking whether this could reduce the ability for new or smaller firms to enter the procurement market (GAO-12-102R, 2011).

It is natural to think that if past performance is important incumbent firms are likely to have an advantage that might deter entrants. The first formal analyses of reputation for quality in the 80s were indeed concerned with how reputational forces sustaining quality could be compatible with free entry (Klein and Leffler 1981,

Shapiro 1983). However, in the case of public procurement and of firms' vendor rating systems, we are talking about reputational mechanisms based on public rules, known and accepted by suppliers, like in eBay. Formal mechanisms and rules give commitment power to the buyer and can be designed in quite different ways (Dellarocas et al. 2006). A common mistake is to assume that they must be designed along the line of the eBay feedback system, where new sellers start with zero reputation. This is a mistake in the sense that a reputational mechanism may well award a positive rating to new entrants - e.g. the maximum, or the average rating in the market - even if they never interacted with the buyer before.

Private corporations often have vendor rating systems in which suppliers start off with the same maximal reputational capital - a given number of points - and then lose points when performing poorly and may recover them by performing well, but keeping below or at best maintaining the initial level. In these quality assurance systems incumbents that already served the buyer may have lost some of the initial reputational capital while any new entrant would start off with the full initial reputational capital. This type of vendor rating system creates an advantage for new suppliers, stimulating rather than hindering entry. This suggests that it is possible to design a reputational mechanism in public procurement that sustains at the same time quality and entry.

To verify this conjecture in Butler, Carbone, Conzo and Spagnolo (2011) we develop a simple 3-period model of competitive procurement with non-contractible quality provision/investment and possible entry (in the third and final period) and implement it in the lab. We use it to ask whether reputation-based procurement must necessarily deter entry and which are the effects of a vendor rating system on quality and price when an entrant can have a positive entry reputation. A reputational scheme rewarding past provision of high quality with a bid subsidy in the next auctions is then

introduced. The potential entrant in the third period has also a bid subsidy in some of the treatments.

We find that in the absence of a reputation mechanism quality provided was low in all periods, prices were higher than production costs and there was a high frequency of entry. When a reputation mechanism is introduced that rewards an incumbent that produce high quality with a bid subsidy in the next auction, provided quality was high, prices were not much higher than in the no reputation treatment and entry became much rarer. When incumbents that produced high quality and the potential entrant have the same reputation/bidding subsidy, delivered quality remained high, prices did not increase significantly but entry was as frequent as in the no-reputation treatment.

If confirmed by other experiments, these findings imply that there is no real trade-off between reputation and entry, i.e. there is no need to give up reputation and quality to increase entry and cross-border procurement in the EU. It is sufficient to appropriately design the reputational mechanism.

3.5 Conclusion

The current debate on whether more flexibility should be allowed in European procurement directives to allow using PP as a policy tool to foster innovation, green technologies and social inclusion etc., seems to ignore the fact that PP is already extensively used as a policy tool to foster European market integration and government accountability. The very strong emphasis on open competitive procedures with little room for past-performance-based contractor selection criteria is mainly driven by the fear that reputational selection criteria and more flexible procurement instruments (negotiations, restricted auctions) could favour local incumbents and keep out foreign suppliers. However, the possible costs of doing this are typically ignored. In a world of imperfect contracting

reputational forces are crucial to achieve efficiency and value for money. The empirical results discussed in this note suggest that the costs in terms of low quality and excessive rigidity of the current use of PP as a policy tool to foster cross-border procurement and public buyers' accountability are likely to be large. Without access to more data it is not as clear as some commentators believe that a more flexible regulation allowing to use PP to also foster other important policy objectives would be more or less distortive – in terms of efficiency and value for money - than the current rigid regulation entirely focused on stimulating cross-border procurement.

Increased flexibility is necessary to use PP as a policy tool to foster sustainable growth, besides European integration, but more flexibility and discretion can facilitate corruption and favouritism. Whether higher corruption or more innovative procurement is the dominant effect of increased flexibility depends how the monitoring and incentive system for public buyers is designed.

Currently, accountability checks and data collection focus on the bidding and contract awarding phases, rewarding civil servants for closely following the rigid procedures even when delivering very bad quality at high cost. Corruption can easily be relocated from the bidding/awarding phase to the contract management/execution stage on which currently there little monitoring. And, as recently shown by Bandiera et al. (2009), the costs of rigid procedures and red tape can be very large compared to gains in accountability even in countries like Italy where corruption is perceived to be a serious problem.

Increased flexibility and empowerment to public buyers, necessary for a more ambitious PP policy, requires a different approach towards accountability, one based on measuring and rewarding ex-post performance rather than on enforcing rigid (and typically inefficient) ex-ante procedural rules. Systematic data collection on (objective and subjective) performance indicators - effectively delivered quality and total expenditures – is the starting point. Reputational mechanisms that imply higher scores in new

supplier-selection procedures are then the natural way of using this information to reward performance rather than ex-ante bureaucratic compliance, but they are certainly not the only way of doing it. Precondition for all of them is ex-post performance data collection. Without performance measurement there cannot be performance-based incentives. National and international procurement oversight bodies should therefore focus much more intensively on coordinating the collection of comparable ex-post performance data that can then be used by monitors for incentive purpose and by researchers for serious empirical analysis.

Procurement regulation is currently changing in Europe, but this process appears itself cursed by a fundamental lack of data and biased knowledge, as the policy evaluation studies commissioned until now by the EC have been poor from all points of view. Rather than hiring poor consultancies to pack poor data in a way that supports the current policy agenda, regulators should focus on improving data collection and on making their data publicly available in a machine-readable form, so that independent researchers can easily use them. Modern policy evaluation techniques will then hopefully be applied (at no cost for regulators) to produce serious and independent assessments of the impact of changes in the procurement regulation.

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4 Understanding the purpose of the EU's procurement directives: the limited role of the EU regime and some proposals for reform

*By Sue Arrowsmith**

4.1 Introduction

In any review of the EU procurement directives it is essential to understand the objectives that the directives seek to pursue. There has sometimes been confusion on this point and this contribution to the debate on review of the directives will thus focus, first, on this fundamental issue. It will be explained, in particular, that whilst it has sometimes been asserted that the directives aim at ensuring value for money for taxpayers, their objective is in fact to achieve an internal market and that value for money per se is not an objective of the directives. Value for money remains a matter for Member States to address, and Member States' interests in dealing with this issue in a manner most suited to their own particular circumstances provide an important constraint in developing the directives.

Taking account of this point, this chapter will then briefly propose an approach to reform which, it is submitted, will provide for a more appropriate balance than the present rules between the objectives of the EU directives and the interests of Member States, including the interests of the latter in obtaining value for money. In this respect, it is suggested that there should be a single directive to

* Achilles Professor of Public Procurement Law and Policy; Director, Public Procurement Research Group, University of Nottingham.

govern all regulated procurement, containing procedural rules that are modelled mainly on those of the current Utilities Directive (2004/17). This should replace the current Public Sector Directive (2004/18), Utilities Directive, and Defence and Security Directive (2009/81), and should also be applied to concessions. Such an approach will both vastly improve the simplicity of the EU procurement regime and offer the necessary flexibility for Member States in implementing their national policies, whilst at the same time providing suitable rules to promote the EU's objective of open markets.

The chapter is divided into three main parts. First, we will discuss the objectives of public procurement regulation in general (section 4.2 below). We will then examine in detail the objectives of the EU procurement directives, the specific means by which they seeks to achieve those objectives, and the relationship between this EU policy and national procurement policy, including the pursuit of value for money (section 4.3). Taking account of the conclusion reached, we will then elaborate our proposals for reforming the directives (section 4.4).

4.2 The objectives of public procurement regulation¹

Before considering the objectives of EU policy specifically, and their relationship with the procurement objectives of Member States, it is useful to outline more generally the various objectives that public procurement regulators may seek to achieve. These regulators include national governments, international organisations – including those organisations that promote trade objectives – and

¹ This section is based in part on S. Arrowsmith, “Basic Concepts and the Coverage of Procurement Rules”, chapter 1 in S. Arrowsmith (ed.), *Public Procurement Regulation: an Introduction*, available at www.nottingham.ac.uk, sections 1.4-1.5, which analyses some of these issues in more detail.

others actors, such as the development banks providing assistance to developing countries, which that regulate the procurement procedures used by those countries for expenditure financed by the banks².

It is submitted that it is possible to identify eight key objectives found in different systems, which are summarised in the Table below. It should be noted, however, that different commentators adopt different classifications. For example, Trepte³ identifies economic efficiency, promotion of social and political objectives and trade objectives as the three “most readily identifiable policy objectives” and treats the objective of reducing corruption as an aspect of allocative efficiency – although we will suggest below that, whilst this is one important aspect of that objective, it is not the only one⁴.

² See generally S. Arrowsmith, J. Linarelli and D. Wallace, *Regulating Public Procurement: National and International Perspectives* (Kluwer Law International, 2000).

³ P. Trepte, *Regulating Procurement: Understanding the Ends and Means of Public Procurement Regulation* (Oxford: OUP, 2004), p. 59.

⁴ Steven Kelman in *Procurement and Public Management* (AEI Press; 1990) identifies economy and efficiency, equity and integrity as the three key objectives, and a similar classification is also adopted by O. Dekel, “The Legal Theory of Competitive Bidding for Government Contracts” (2008) 37 P.C.L.J. 237. On objectives see also S. Arrowsmith, J. Linarelli and D. Wallace, note 2 above, chapter 1 and chapter 2; and S. Schooner, “Desiderata: Objectives for a System of Government Contract Law” (2002) 11 *Public Procurement Law Review* 103.

Table Objectives of Public Procurement Systems

1. Value for money (efficiency) in the acquisition of required goods, works or services
2. Integrity - avoiding corruption and conflicts of interest
3. Accountability
4. Equal opportunities and equal treatment for providers
5. Fair treatment of providers
6. Efficient implementation of industrial, social and environmental objectives (“horizontal policies”) in procurement
7. Opening up public markets to international trade
8. Efficiency in the procurement process

Within different public procurement systems the existence of different objectives and the weight attached to the various objectives can differ markedly. For example, some systems attach much more importance than others to policies of fair and equal treatment of providers, to the use of procurement to promote social objectives or to accountability – with the result that the government may be willing to pay higher prices for goods or services or to accept greater process costs to implement these values.

The first objective mentioned in the table is a major objective of most – probably all – national procurement systems, namely successfully to acquire the goods, works or services concerned on the best possible terms⁵. This is often referred to as value for money⁶, or

⁵ As noted below a procuring entity will also want to ensure that these the benefits of horizontal policies are obtained in a way that gives good value (is efficient). It is for this reason that we have labelled the current objective ‘value for money (efficiency) in the acquisition of required goods, works or services’, rather than simply ‘value for money’ although we will use the abbreviated “value for money” or “best value” below.

⁶ Arrowsmith, Wallace and Linarelli, note 2 above.

efficiency, or economic efficiency⁷. This objective can be seen to have three aspects: ensuring the goods, works or services acquired are suitable (both i) ensuring that they can meet the requirements for the task in question and ii) that they are not over-specified (“gold-plated”)); concluding an arrangement to secure what is needed on the best possible terms (which does not necessarily mean the lowest price); and ensuring the contracting partner is actually able to provide the goods, works or services on the agreed terms.

It has often been said that this is the primary goal of most procurement systems, although this is by no means a universal view, nor perhaps true of every procurement system (Dekel, for example, considers that integrity rather than efficiency is the overriding goal of competitive bidding in public procurement, and also that the principle of equal treatment as an independent objective of the procurement process should be equal in status to value for money⁸). Certainly it is the case, however, that many of the regulatory rules that apply in public procurement – such as the basic requirements for transparency and competitive bidding - have the realisation of value for money as one of their aims. Such rules are designed, in particular, to ensure that value for money is not prejudiced by inefficient behaviour, and also that it is not prejudiced by deliberate misconduct, notably corrupt behaviour and (where the system prohibits this) discrimination in favour of national firms. Eliminating corruption and eliminating national preferences (an aspect of opening up procurement to international trade) can also be seen as

⁷ See Dekel, note 4 above, and Trepte, note 3 above. However, note that Dekel includes within the objective of efficiency as one meaning of that concept not merely obtaining value for the goods, works or services acquired, but also the overall economic benefits to society of efficient allocation of resources (see further below) and Trepte seems also to refer to this latter concept of efficiency. Trepte also incorporates the goal of efficiency in the process into this single concept of efficiency.

⁸ Dekel, note 4 above.

independent objectives of procurement systems that go further than the objective of obtaining value for money in acquiring goods, works or services – but they are also one important part of that last objective.

To a certain extent policies and tools that support the goal of value for money in acquiring goods, works and services - such as competitive bidding and transparency - are the same policies and tools that support other objectives, and thus there is a complementary relationship between them. On the other hand, there are also situations in which achieving value for money in the goods, works or services acquired, especially if the focus is on the particular procurement in question, may come into conflict with other goals, and an appropriate balance must be drawn between the two. An example is the case in which a procuring entity receives a bid which does not comply with the specification: for example, the specification may have been poorly drafted and in its terms exclude some products that the procuring entity in fact finds perfectly suitable⁹. In this case a principle of equal treatment might suggest that the bid should be rejected – but if the bid is the best one submitted the principle of value for money as applied in the particular transaction might indicate that it should be accepted, as it will provide better value for the procuring entity. Another potential area for conflict is with rules to prevent corruption – as elaborated at below, the rules that are designed to reduce corruption by limiting the discretion of procuring entities, and hence limiting opportunities for abuse to favour a particular supplier, may also curtail discretion that could be used to obtain better value for money. Further, in considering how to achieve value for money often there are also conflicts to be resolved between actions which will achieve value for money in the short term and those based on principles that are designed to promote value for money in the longer term by encouraging suppliers to have

⁹ For a general discussion of the issues see Arrowsmith (ed.), chapter 3, section 4.3.2, note 1 above.

confidence in, and participate in, the public market. An example can again be given by reference to the issue of a tender that does not conform with the specification. As discussed below, as well as being an independent objective of the procurement process, the principle of equal treatment can also operate to support other objectives, including supporting value for money by maintaining confidence of tenderers in the procurement process, which will encourage them to tender in the future and hence promote greater value for money. Thus in the case of the non-conforming tender referred to above, if rejection of such tenders is considered as giving effect to equal treatment, this can be seen not merely as supporting a separate objective of equal participation but also as supporting value for money in the procurement system as a whole – rather than the individual transaction – by encouraging participation. In this case a conflict can be seen between short term value for money (value in the particular procurement) and value for money overall in the system.

A second important objective of many public procurement systems, and of public procurement regulation, is to ensure integrity in the system. Integrity refers, first, to the idea that procurement should be carried out without any influence of corruption.

There is a close and obvious connection and complementary relationship between this second objective of integrity and the first objective of ensuring value for money in acquiring the needed goods, works or services.

First, the award of contracts on the basis of corrupt considerations such as a bribe or personal relationship may prevent authorities from achieving value for money in their acquisitions, since it may mean that contracts will not be awarded to the best firms (as often in the case of contracts awarded to family or political supporters) or, even when this is the case, that the government will not obtain the benefit of the most competitive offer that would be put forward in a fair competition. (It can be noted that where bribery is endemic the contract may often in fact be awarded to the best firm, since the firm with highest profit margin will be able to pay the

highest bribe). In addition, corruption scandals may deter firms from bidding for future contracts. The terms obtained by government may also generally be less favourable in a market in which corruption is a problem because contractors doing government work need to add on a premium to take account of the risk of corruption (that may affect them because they are denied contracts that they would have won under fair competition). Thus reducing corruption will often have the result of improving the value for money obtained when acquiring the goods, works or services.

Secondly, to a great extent the same kind of measures are useful to address both the damage to value for money that can occur from a failure to act efficiently and damage to value for money resulting from corruption (and also from other unlawful abuses, such as preferences for national firms in contravention of international trade rules, as discussed further below). Thus competitive bidding and transparency, as discussed at further below, are fundamental tools for addressing corruption as well as many other facets of value for money.

However, whilst it is the case both that achieving value for money is an important reason to provide for integrity in the procurement system, and that the means for doing so are similar to the means used for achieving other aspects of value for money, integrity cannot necessarily be seen only as a step towards value for money – there are many reasons going beyond it why this is an objective of procurement systems. One reason is that it is considered that governments should seek to follow the highest standards of conduct for their own sake, and that individuals should not make profits from public office; another is that it is considered important for the government to set an example as a means of discouraging corruption in the economy more generally, particularly if this is a significant problem in economic life. In countries in which organised crime groups are heavily involved in corrupt practices in public

contracts (e.g. New York State in the United States¹⁰), preventing corruption may also be seen as important in reducing the financial resources of those groups. For these reasons preventing corruption can be seen as an independent objective of procurement regulation, which is not necessarily tied to value for money. Political considerations probably also help to explain why governments are often particularly concerned to address corruption even if this is not justified on other grounds – governments are likely to suffer political damage if corrupt practices come to light.

As is the case with the relationship between many of the procurement objectives discussed in this section, the objective of integrity may sometimes conflict with other objectives of the system. Thus there may sometimes be a tension between the objective of preventing corruption and ensuring efficiency in the administration of the procurement process. Suppose, for example, that requirements for all major contracts to be approved by a special committee, and not just by the contracting officer responsible for the procurement, would cost £500 000 per annum to implement (in terms of extra staff time, paperwork etc.). This cost of the approval system will generally be considered to be justified if, by deterring corruption, more than £500,000 is saved through obtaining improved value for money. However, if corruption in a particular country is very rare and only, say, £100,000 would be lost from corruption without it, the approval procedure will not be justified financially. The government must then ask whether preventing corruption is so important in its own right for the other reasons given above that the necessary financial resources should be expended to prevent it.

Whilst to a large extent, as we have noted, ensuring integrity also supports and promotes value for money in acquiring goods, works or services, there are also situations in which it might conflict with

¹⁰ On this see, for example, F. Anechiarico and J. Jacobs, "Purging Corruption from Public Contracting: the Solutions are Now Part of the Problem" (1995) 40 *New York Law School Law Review* 143.

this objective. For example, if value for money were the only concern it might, in a particular system, be appropriate to allow a certain degree of discretion to procuring officers – for example, to allow use of procedures that allow non-price as well as price criteria in evaluating tenders, or to allow a degree of negotiations with tenderers after the submission of initial tenders to allow tenderers to adapt their tenders and enhance value for money after feedback from the procuring entity. However, greater discretion that might produce improved value for money across the whole procurement system (even taking account of corruption) can also open up greater opportunities for corruption than would apply if this discretion were constrained – and for this reason a procurement system might choose to forego value for money to some degree in order to reduce corruption.

We have so far considered the issue of actual corruption but the concept of integrity, or probity, often embraces not only the prevention of actual corruption but also the goal of preventing any appearance of impropriety. For example, there may be rules that prohibit certain kinds of conflicts of interest or require these interests to be declared. One important reason for this is that it might help prevent corruption by deterring corrupt behaviour and improving detection rates. Such rules also, however, can be seen to support the separate objective of accountability.

A third objective of many public procurement systems is to ensure accountability in the sense that the system provides means for interested parties to establish whether the government is meeting its objectives. Such interested parties can include, for example, the general public, tenderers, and – under international systems of procurement – other states. Ensuring that the objectives and rules of the procurement system can be monitored and enforced is one of the dimensions of transparency, which in general, including this accountability aspect, is important as a *means* to achieve many of the objectives of a procurement system, including value for money and integrity. However, accountability can also sometimes be considered as a value in its own right, especially in democratic countries. As

Dekel states¹¹ “Whilst [transparency] may play some role in the prevention [of corruption] by making it more difficult for the culprit to get away with it, transparency is of more importance to restore faith in the system for contractors and the taxpayers by allowing them to see exactly what transpires in the government contracting arena”.

Many public procurement systems also refer to a principle of the equal treatment of those participating in the system. For example, this is often referred to in the public procurement systems of the United States¹² and it is also a fundamental principle of EU procurement law¹³. In the United Kingdom the government has stated that competition is important not only as an aid to value for money "but because it provides fair access to work paid for by the taxpayer"¹⁴. The concept of equal treatment in public procurement may take on two different roles. First, it may serve simply as a means to achieve other objectives of the public procurement system, such as value for money in obtaining goods, works and services, preventing corruption and opening up markets to competition. Thus holding a competition in which all interested firms have an equal opportunity to participate is often the method chosen for seeking out the best terms for the goods, works and services. Requiring that those involved in the competition are treated on an equal basis during the conduct of the competition can help ensure value for money and/or prevent corruption in the procedure in two ways by limiting the opportunities for the procuring entity to make discretionary decisions that could be abused to favour particular firms (for

¹¹ Dekel, note 4 above.

¹² See Dekel, note 4 above.

¹³ Joined Cases C-21/03 and C-34/03, *Fabricom v État Belge* [2005] E.C.R. I-1559.

¹⁴ In the 1995 White Paper, *Setting New Standards: a Strategy for Government Procurement*, (1995) Cm.2840.

example, a firm that has paid a bribe or – from the perspective of opening up markets – a national firm); and by encouraging firms to have confidence in the process and thus encouraging the best firms to participate in the procedure. Secondly, however, in addition to serving as a means to support other procurement objectives, equal treatment may also serve as an objective of the procurement process in its own right. As Dekel has explained:

“In selecting its business partners, a procuring entity determines who will benefit from the economic advantage inherent in a contractual relationship with it... The fact that the transaction involves public funds or assets, coupled with the fact that Government owes a fiduciary duty to the public at large, obliges the contracting authority to accord all members of the public an equal opportunity to enjoy this public benefit that the government has decided to allocate”¹⁵.

Equal treatment may also be seen as an independent objective of procurement systems from another perspective, in that it is a reflection of a more general value adopted in some countries of equal treatment of persons by the administration.

One problem with the equal treatment principle is that it is often not entirely clear in a given system what role it is intended to play – whether it is merely a means to other objectives or an objective in its own right. Dekel, for example¹⁶, notes that some US instruments seem to regard the principle as a separate objective, but on the whole whilst the courts treat it as a fundamental (important) principle, it is as a subsidiary one – a means to other ends. However, it is clear that it may serve also as a separate objective of a public procurement system in some cases.

The *fair* treatment of suppliers is also sometimes regarded as a separate value in the procurement process. This can involve, for example, concepts of procedural fairness (or “due process”) according to which suppliers have a right to have their case heard before a decision is made that affects them adversely, and/or a right

¹⁵ Dekel, note 4 above, p. 246.

¹⁶ Dekel, note 4 above.

to know the reasons for such decisions – for example, a decision to debar them from government contracts. It may even involve the concept of protection of “rights” – for example, a firm’s right to its reputation. Some of the rules or procedures associated with the fair treatment of suppliers may, of course, help to support other objectives of the procurement process - thus allowing a supplier to put its case before being debarred from procurement can improve the quality of debarment decisions and perhaps thus avoid unjustified debarment of a firm that could provide the best value for money - and, more generally fair treatment will encourage the best firms to participate in government procurement, again enhancing value for money. However, as with equal treatment, to the extent that fair treatment is considered an independent value in the procurement process, there may sometimes be a degree of conflict between this value and other objectives, such as value for money and procedural efficiency. For example, the principle of fair treatment might suggest that a supplier who has invested significant resources in a procurement process (for example, in preparing a tender for a complex project) and then has been excluded because doubts have been raised over its integrity should be allowed to defend itself against these allegations before the contract is awarded, so that it does not lose the chance to compete if the allegations are ill-founded. However, the need for a speedy conclusion of the procurement process in order to ensure the timely acquisition of the goods, works and services may make it difficult to delay the procurement until an appropriate hearing is held.

A sixth possible objective of a procurement system is the efficient implementation of industrial, social and environmental policies through public procurement. As we have already noted above, procurement may be used to achieve benefits that go beyond the mere acquisition of the goods, works or services. For example procurement may be used to support the economic development of disadvantaged groups of society or regions of the country, by setting aside some public contracts for those groups or regions; or it may be

used to promote government objectives such as fair treatment of workers by denying public contracts to firms that do not comply with specified standards on these matters. Procurement policies of this kind can be industrial, social, environmental or political in nature, and are sometimes referred to generically as “secondary” policies (common terminology in the EU, for example), “collateral” policies (US terminology), socio-economic policies, or “horizontal” policies¹⁷.

As with the acquisition of the required goods, works or services, governments will wish to ensure efficiency in the way that horizontal policies are implemented – for example, that it does not pay more than is necessary for the addition of horizontal benefits in the procurement, and that the selected supplier is able to actually deliver any horizontal benefits that it has undertaken to provide. The implementation of such objectives through public procurement may sometimes be supportive of other objectives, or at the very least neutral. An example is a policy of improving access to procurement for small and medium sized enterprises (SMEs) by providing training on public procurement procedures or by providing better information – the wider participation that results may lead to better quality tenders and hence improved value for money. However, more often, implementing horizontal policies will involve a trade-off with other objectives. For example, allowing entities to consider horizontal benefits as well as “commercial” benefits in a procurement may increase the degree of discretion in the procurement process in a way that may make it easier to favour particular firms, to the detriment of the objective of integrity; or may make the procurement process more complex and so increase procedural costs for both the procuring entity and suppliers. It may also have the effect of limiting access to markets for foreign suppliers

¹⁷ The author prefers this last term for reasons explained in S. Arrowsmith and P. Kunzlik (eds), *Social and environmental policies in EC procurement law: new directives and new directions* (CUP; 2009), pp.12-15.

to the detriment of the objective of opening up markets to trade – for example, a set-aside of a proportion of government contracts for firms in a region of high unemployment in order to increase regional equality in the country will have the effect of shutting out firms from abroad.

A further goal which is of increasing importance is the opening up public markets to international trade. One of the most important developments in public procurement in the last 20 years has been the conclusion instruments (by groups of states or in regional and global organisations) that are designed to open up public procurement to international trade. These instruments either require or encourage countries to implement measures to improve foreign access to their public procurement markets¹⁸. Often public procurement markets have been relatively closed to foreign suppliers for various reasons, most notably the fact that governments have deliberately favoured domestic industry in awarding contracts. The development of rules to open up public procurement markets has been part of a general movement towards free trade that has occurred since the Second World War, and the subject of public procurement has become increasingly important in this context as other barriers to trade – such as tariffs and import quotas – have gradually been removed or reduced. The basic rationale for such free trade policies is that opening up markets to foreign competition improves economic prosperity. Underlying this is the theory of comparative advantage elaborated by Ricardo. In brief, this states that both total economic

¹⁸ On the regime of the WTO itself see S. Arrowsmith, *Government Procurement in the WTO* (Kluwer Law International; 2003), and for recent developments, S. Arrowsmith and R. D. Anderson (ed.), *The WTO Regime on Government Procurement: Challenge and Reform* (CUP; 2011) *passim*. For information on regional and other non-multilateral agreements see R. D. Anderson, A. C. Müller, K. Osei-Lah, J. Pardo De Leon and P. Pelletier, *Government Procurement Provisions in Regional Trade Agreements: a Stepping Stone to GPA Accession?*, chapter 20 in Arrowsmith and Anderson, above.

welfare of the free trade group and the welfare of each individual country will be maximised by free trade between the members: such free trade leads each state to specialise in those areas in which it has a comparative advantage, resulting in the most efficient use of resources and thus enhancing wealth¹⁹. As we will elaborate further below, it is this goal that is the most central element of the EU's directives on public procurement.

Finally, a final goal of any procurement system is to ensure that the procurement process itself is carried out efficiently. This requires that the process is carried out without unnecessary or disproportionate delay or waste of resources for the procuring entity, and also without unreasonable costs for suppliers. To a certain extent this is complementary to other goals – good suppliers will be more willing to participate in an efficient process and this can produce better value for money. We have already observed above, however, that some trade-off is necessary between this goal and other objectives of the process. For example, both the objective of value for money in acquiring the goods, works or services and the objective of equal treatment (in the sense of equal access to the opportunities of government business) might suggest that contracts should generally be awarded by open tender in which any qualified firm may participate; but the costs of submitting and evaluating a large number of tenders may be considered disproportionate to any

¹⁹ See Cecchini, *The European Challenge: the Benefits of a Single Market*, section 3, 16-21 (1988); F. Trionfetti, "Home biased government procurement and international trade", in S. Arrowsmith and M. Trybus (eds.), *Public Procurement: the Continuing Revolution* (London: Kluwer Law International 2002); S. Evenett and B. Hoekman, "Government Procurement of Services and Multilateral Disciplines", ch.6 in P. Sauvé and R. Stern (eds.), *GATS 2000: New Directions in Services Trade Liberalization* (Washington: Brookings Institution Press 2000); A. Mattoo, "The Government Procurement Agreement: Implications of Economic Theory" (1996) 19 *World Economy* 695; F. Sseneoga, "Examining Discriminatory Procurement Practices in Developing Countries" (2006) 6 *Journal of Public Procurement* 218.

benefits to these objectives, with the result that a selective tendering procedure (limited to invited firms only) is considered more appropriate.

It is important finally for our analysis to mention also the existence of two key principles for implementing procurement objectives, namely transparency and competition²⁰. These are sometimes referred to as objectives or goals of a public procurement system. However, they are not listed in the objectives set out above since they are in fact a means used to achieve one or more of the objectives mentioned above, rather than objectives in their own right.

²⁰ See further S. Kelman, "Remaking Federal Procurement" (2002) 31 *Public Contract Law Journal* 581; S. Kelman, note 4 above; S. Arrowsmith, J. Linarelli and D. Wallace, *Regulating Public Procurement: National and International Perspectives* (London: Kluwer Law International 2000), p.72 *et seq*; S. Arrowsmith, "The EC Procurement Directives, National Procurement Policies and Better Governance: The Case for a New Approach" (2002) 27 *European Law Review* 3; S. Schooner, "Commercial Purchasing: the Chasm between the United States Government's Evolving Policy and Practice", Ch. 8 in S. Arrowsmith and M. Trybus (eds.), *Public Procurement: the Continuing Revolution* (London: Kluwer Law International 2002); S. Schooner, "Fear of Oversight: the Fundamental Failure of Businesslike Government" (2001) 50 *American University Law Review* 627; J. Schwartz, "Regulation and Deregulation in Public Procurement Law Reform in the United States", Chap. 8 in G. Piga and K. Thai (eds.), *Advancing Public Procurement: Practices, Innovation and Knowledge-sharing* (Boca Rato: PRAcademics Press 2007); P. Trepte, *Transparency and Accountability as Tools for Promoting Integrity and Preventing Corruption in Public Procurement* (2005) (paper to OECD Expert Group meeting on Integrity in Public Procurement); C. Vacketta, "Lessons from the Commercial Marketplace" (2002) 11 *Public Procurement Law Review* 126; W. Wittig, "A Framework for Balancing Business and Accountability within a Public Procurement System: Approaches and Practices of the United States" (2001) 10 *Public Procurement Law Review* 139.

Transparency, in particular, warrants further consideration here²¹ both because of its central importance in the EU procurement directives, and because of its relevance for the theme of this article. Broadly speaking the concept refers to the idea of openness. However, it has rarely been precisely defined, including in regulatory systems that give it central emphasis. This is the case with the EU system itself. Thus transparency is expressly provided as a general principle under the EU procurement directives²², which has been used by the Court of Justice of the European Union (CJEU) both to interpret explicit rules in the directives and to develop additional obligations²³, and it is also a principle applicable to public procurement under the EU Treaty rules on free movement, as articulated in the Court's case law²⁴, but in neither context has the CJEU given any kind of definition of the principle. Arrowsmith, Linarelli and Wallace have suggested that the concept can in fact be broken down into four distinct aspects, namely²⁵.

1. Publicity for contract opportunities.
2. Publicity for the rules governing each procedure. This involves both publicity for the general regulatory rules of the system and disclosure to suppliers of the specific rules laid down for a particular procurement.
3. A principle of rule-based decision-making that limits the discretion of procuring entities or officers. Requirements to formulate and publish the rules of the particular award

²¹ The role of competition is examined further in P. Trepte, note 3 above, pp.70-87.

²² For example, Directive 200/18, Article 2.

²³ For elaboration and discussion see Arrowsmith (ed.), note 1 above, chapter 6, section 6.1.

²⁴ *Ibid*, chapter 3, section 3.4.

²⁵ Arrowsmith, Linarelli and Wallace, note 2 above, pp. 72-73.

procedure – such as the award criteria to be used - also relate to this aspect, as they not only ensure publicity but also constrain discretion. Rigid limits on discretion are a particular aspect of public sector award procedures and can be seen to have several purposes. One is to safeguard against poor decision-making – laying down rules about how the process should be conducted rather than relying on individuals to make decisions on the facts of each case can help ensure that procuring officers make appropriate decisions that are based on the accumulated wisdom of experience, as embedded in the regulatory rules. Another is to safeguard against abuse – rule-based decision-making and limited discretion ensures that decisions can be better monitored to prevent decisions being made on the basis of corrupt motives or (where this is prohibited by the system) to favour national or local suppliers. Thus, for example, if the criteria for awarding contracts are formulated, it is not possible for the procuring officer to state retrospectively criteria that would favour a specific bidder in order to ensure that bidder is successful.

4. The possibility for verification of the fact that the rules have been followed and for enforcement where they have not. The former is assisted of course by rule-based decision-making. It can also be supported by further requirements such as obligations to provide tenderers with reasons why they have been rejected or requirements to keep a record of and/or publicise the reasons for certain decisions.

Each of these aspects may fulfil one or more of the objectives referred to above. For example, publicity for contract opportunities obviously supports value for money by ensuring that the best suppliers know about an opportunity, and helps open up contracts to trade when publicity is required in a form accessible to foreign suppliers. Publicity for the rules of each procedure, such as the award criteria,

helps ensure that tenderers submit tenders that best match the procuring entity's priorities, thus ensuring better value tenders. Limits on discretion help prevent decisions based on illegitimate considerations, such as decisions based on corrupt motives (thus supporting the objective of integrity) or – important in the context of trade regimes, as we will discuss later below - decisions that favour national suppliers. Eliminating the possibility for decisions based on these motives will also enhance value for money. Such limits also help maintain the confidence of contractors in the system, encouraging participation and thus better value for money. The combination of publicity for the applicable rules and the existence of substantive limits on discretion also promote the objective of accountability. (Accountability as an objective and transparency as a tool are closely linked but it is important to separate the end and the means here, since transparency is also a means to promote many other objectives).

However, whilst transparency is a very important value in public procurement, it is essential also to realise that it can also have costs and can in certain ways detract from, as well as support, public procurement objectives²⁶. One important aspect of this issue has been neatly put by Kelman as follows²⁷:

“As a strategy of organizational design, rules have a cautious character. When we design organizations based on rules, we guard against disaster, but at the cost of stifling excellence.....Government officials deprived of discretion which could produce misbehaviour are at the same time deprived of discretion that could call forth outstanding achievement”.

Examples of ways in which transparency rules may hinder the attainment of procurement objectives have been highlighted by

²⁶ See, in particular, the works cited in note 20 above.

²⁷ Kelman, note 4 above, p. 28.

Arrowsmith, for example, in the context of the EU procurement system (footnotes omitted)²⁸:

“Thus, for example, requirements for a competition may help ensure that decisions are not influenced by corrupt or discriminatory motives or based on poor market information. However, they may also preclude a better deal than could be had, for example, from snapping up an exceptional bargain through a liquidation sale or promotional offer. Competition requirements also preclude “partnering” relationships extending over more than one contract, a strategy which may produce long term benefits such as an incentive to excellent performance and co-operation in developing new products. Strict competition requirements with only limited exceptions based on verifiable criteria, as found in the directives and many national laws, may lead to more commercial procurement for those cases in which corruption, discrimination or bad judgement would otherwise have led to an abusive or unwise choice - the “disaster” Kelman refers to. However, they may produce a less commercial result when, without the requirement, the particular (honest and competent) purchaser would have obtained a more advantageous deal through other means – the “excellent” result.

..... Transparency can also affect commercial objectives by increasing costs. An example is the greater preparation and evaluation costs of using open procedures. Requiring complete tenders that can be accepted or rejected without discussion also adds greatly to participation and assessment costs, especially in complex projects. (A recent United Kingdom study found that bidding costs on public projects were typically 10-50% higher than on comparable private sector projects). The bureaucracy of transparency rules can also deter competitive firms”.

It is in fact one of the most difficult issues for procurement policy to determine the appropriate balance between using rules to control the behaviour of individual agents of the procurement system (the procuring officers) and allowing them discretion. We will return to this issue in the discussion of the procurement directives below.

²⁸ S. Arrowsmith, “The EC Procurement Directives, National Procurement Policies and Better Governance: The Case for a New Approach” (2002) 27 *European Law Review* 3.

4.3 The objectives of public the EU procurement directives

4.3.1 General principles

We may now turn to consider the objectives of the EU directives on public procurement and the relationship between these objectives and the other objectives of public procurement regulation that were outlined above. In the context of the current reform programme, it is relevant to consider both the objectives of the directives currently adopted and the objectives which those directives could potentially serve.

The starting point of the analysis is that the EU does not have a general power to legislate: under the principle of conferral it must act within limits of competence conferred by the Member States under the EU Treaties for the purpose of obtaining the objectives of the Treaties (Article 5(2) of the Treaty on European Union)²⁹. The main directives regulating public procurement procedures³⁰, Public Sector Directive 2004/18³¹ (regulating the procurement of most public sector

²⁹ See generally S. Weatherill, *Cases and Materials on EU Law* (9th ed. 2010), pp.33-47.

³⁰ See generally Arrowsmith (ed.), note 23 above; S. Arrowsmith, *The Law of Public and Utilities Procurement* (2nd edn. Sweet & Maxwell, 2005); P. Trepte, *Public Procurement in the EU: a Practitioner's Guide* (Oxford University Press, 2007).

³¹ Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114.

bodies) and Utilities Directive 2007/17³², regulating the procurement of certain utilities), as well as the Defence and Security Directive 2009/81 regulating defence and security procurement³³, were adopted under Article 47(2) EC, Article 55 EC and Article 95 EC (now Articles 53, 62 and 114 TFEU). These are concerned with the power to legislate for the creation of the EU's internal market and allow measures which either contribute to eliminating obstacles to the free movement of goods and the freedom to provide services or which contribute to removing distortions of competition³⁴. Thus essentially the directives are concerned with the seventh objective identified above - that is with opening markets up to trade. This is, of course, an aspect of the EU's general internal market policy.

4.3.2 The means for achieving the internal market objectives

As we saw in section 4.3.2, the opening up of public markets to international trade and competition has been a significant development at a global level over the last twenty years, and there are in fact a number of different means, or strategies, that can be used to achieve this objective. To understand the nature of the EU's current public procurement regime, the limits on its powers and the

³² Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors [2004] OJ L134/1.

³³ Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC, OJ 2009 L 216/76.

³⁴ See, for example, Case C-376/98, *Germany v Parliament and Council* [2000] E.C.R. I-8419.

relationship between these rules and the powers of Member States it is necessary also to understand which of these *means* are, or may be, employed by the EU in pursuit of its own objective of creating an internal public market in the EU.

Three means to promote the internal market in the directives

It appears that there are at least three ways in which the current directives seek to achieve the internal market goal, which it cannot be disputed are also within the competence of EU regulators.

First and foremost, the EU procurement rules prohibit discrimination in public procurement on grounds of nationality. This is found as an obligation in most international instruments that seek to open up procurement markets since the existence of discrimination is the core problem that most such systems seek to address (although access to markets can also be promoted without such obligations - for example, by improving access to existing *de facto* opportunities through greater transparency³⁵). Prohibitions on discrimination on grounds of nationality are in fact found in the Treaty on the Functioning of the European Union itself under which - in contrast with most other regimes³⁶ - they are in general in nature with only limited exceptions, rather than being negotiated merely for specified areas of public procurement. These obligations are also, however, expressly stated in the directives, one effect of which might be to extend them to some entities governed by the directives that

³⁵ Which was one perception of the purpose of a possible agreement on transparency that has been mooted within the WTO: see further S. Arrowsmith, "Transparency in Government Procurement: the Objectives of Regulation and the Boundaries of the World Trade Organization" (2003) 37 *Journal of World Trade* 283 (though note that the study of the possibility of a transparency agreement is currently on hold).

³⁶ Including that of the WTO: see further the works cited in note 18 above.

are not covered by the Treaty obligations, particularly private utilities covered by Utilities Directive 2004/17³⁷.

Secondly, and significantly, the directives also impose obligations for covered entities to use transparent award procedures with the purpose of prevent entities from concealing discriminatory behaviour behind a cloak of subjective decision-making. This has always been the primary aim of the directives, it being considered that simply prohibiting discrimination, as done under the Treaties would be insufficient to open markets without some means for monitoring the application of the prohibition. Thus, whilst the recitals to the first directive on works (Directive 71/305/EEC) refer merely to the need for ‘co-ordination of national procedures’, later recitals refer specifically to the purpose of monitoring application of the restrictions on discrimination and other hindrances to trade. Thus Directive 77/62/EEC (the original coordination directive on public supply contracts), states the need for transparency ‘allowing the observance of [the prohibition on measures restricting imports] to be better supervised’ and Directive 89/440/EEC (amending Directive 71/305/EEC on public works) refers to the need to improve transparency ‘in order to be able to monitor compliance with the prohibition of restrictions [on freedom of establishment and freedom to provide services] more closely’. A requirement for transparency in public contracts has more recently – and controversially - been implied by the CJEU under the free movement provisions of the TFEU for the same purpose³⁸. As we have noted above, transparency rules are also an important means adopted by national governments

³⁷ On the application of the Treaty to such entities see Arrowsmith, note 30 above, ch.15.

³⁸ Case C-324/98, *Telaustria v Telekom Austria and Herold Business Data* [2000] ECR I-10745. For recent commentary see A. Brown, “EU Primary Law Requirements in Practice: Advertising, Procedures and Remedies for Public Contracts outside the Procurement Directives” (2010) 19 *Public Procurement Law Review* 169.

in their own procurement systems to achieve national procurement goals such as value for money and integrity. However, as the recitals indicate, this is not their role under the directives, where the concern is to support the Treaty's prohibition on discrimination.

Thirdly, the directives also remove certain restrictions on access to the market – even, in certain cases, non-discriminatory restrictions – that are disproportionate in light of their objectives. For example the Public Sector Directive contains a limited list of evidence that purchasers may require from firms to assess their technical capacity, in order to limit the burden of participation.

We can also note that, as mentioned above, the directives go beyond merely prohibiting discrimination on grounds of nationality and impose a general principle of equal treatment³⁹ - this also applies to domestic firms (who benefit from, and can enforce, the public procurement directives, along with firms from other Member States)⁴⁰.

Promoting the internal market through standardisation of legal rules?

Another possible approach for regimes that seek to open up public markets to trade is to seek a degree of standardisation in public procurement procedures between states, on the basis that familiarity with the procedures used encourages participation in foreign markets. The promotion of trade through the standardisation of public procurement procedures is, in particular, the main aim of the

³⁹ See, for example, Article 2 of Directive 2004/18; discussed in Arrowsmith, note 23 above, at 6.1. Although the Commission has argued that an equal treatment principle of this kind applies under the Treaty and this was apparently endorsed in Case C-458/03, *Parking Brixen GmbH v Gemeinde Brixen and Stadtwerke Brixen AG* [2005] ECR I-8585 this view has more recently been rejected by the CJEU: Case C-95/10, *Strong Segurança SA v Município de Sintra*, judgment of 17 March 2011.

⁴⁰ Case C-87/94, *Commission v Belgium* ("Walloon Buses") [1996] ECR I-2043.

UNCITRAL Model Law on Public Procurement⁴¹ and is also an aim of the COMESA public procurement regime in Africa⁴². Greater standardisation of procedures has certainly been one effect of the EU procurement regime and it appears that the degree of standardisation may have increased as a result of the 2004 reforms, since the new mechanisms introduced in 2004 have to a large extent been adopted without change or elaboration by many Member States⁴³. However, this does not appear to have been referred to in the formal texts as an *intended effect* of the rules⁴⁴.

Whatever the position with the current directives, it is relevant to consider whether this might be an approach that the directives could pursue, particularly since the issue of national differences was raised in the Commission's 2011 Green Paper on modernisation of the EU procurement rules. Thus, in the context of considering the issue of reform to the contract award procedures, the Green Paper states:

⁴¹ For the (recently revised) text see www.uncitral.org and on the objectives of the Model Law S. Arrowsmith, "Public Procurement: An Appraisal of the UNCITRAL Model Law as a Global Standard" (2004) 53 *International and Comparative Law Quarterly* 17.

⁴² See further S.R. Karangizi and I. Ndahiro, "Public Procurement Reforms and Development in the Eastern and Southern Africa region" in R. Hernández Garcia (ed.), *International Public Procurement: a Guide to Best Practice* (Globe Law and Business, 2009) 113; E. Nwogwugwu, "Towards the Harmonisation of International Procurement Policies and Practices" (2005) 14 *Public Procurement Law Review* 131.

⁴³ For example, the rules on the competitive dialogue procedure: see S.Arrowsmith and S.Treumer (eds.), *Competitive Dialogue in EU Procurement Law* (forthcoming; CUP).

⁴⁴ Although it has been suggested that this might be an objective: A. Haagsma, "Information and Communication Technology Issues in International Public Procurement", ch.9 in Arrowsmith and Davies, *Public Procurement: Global Revolution* (1999) at pp.169-170.

“It should also be borne in mind that the EU rules are complemented by a large body of rules at national or regional level. Regulation that is repealed at EU level might be replaced at other levels, thus creating a risk of more diverse national legislation and possibly more national gold-plating”⁴⁵.

Here the Green Paper contemplates that curtailment of national differences might be a reason to refrain from simplifying procedures under the current review.

It is submitted, however, that standardisation of award procedures merely for the benefits of legal simplicity for traders from other Member States is not a permitted approach under the powers to legislate for the creation of an internal market. In the first *Tobacco Advertising* case the CJEU stated that mere disparities in national rules do not justify EU-level regulation under the internal market provisions⁴⁶. In the second *Tobacco Advertising case* it stated that they will do so only where they are “such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market”⁴⁷ – and in that case found that narrowly-drawn restrictions on advertising of tobacco products in certain kinds of media were acceptable because of the possibility that such restrictions might lead to restrictions on the sale of the media in question in other Member States that had stricter rules against such advertising. The general statement in the first case that mere disparities in national rules do not justify harmonising legislation at EU level was a response to an argument that the internal market provisions may be invoked to harmonise national rules to eliminate

⁴⁵ European Commission, Green Paper on the modernisation of EU public procurement policy: Towards a more efficient European Procurement Market COM (2011) 15 final, para. 13.

⁴⁶ Case C-376/98, *Germany v Parliament and Council*, note 34 above, para. 84.

⁴⁷ Case C-380/03, *Germany v Parliament and Council* [2006] ECR I-11573, para. 37.

distortions of competition arising from different regulatory conditions to which economic operators might be subject in different Member States, rather than at the complexity of working under different legal rules when operating in a different Member State from one's own. However, the logic of the principle that allowing harmonisation in order to eliminate disparities per se without some more specific impact on the internal market would risk transferring general Member State regulatory competence to the EU, as articulated by Advocate General Fennelly in that case⁴⁸, is equally applicable in the latter context. That logic and the context of the decision suggests, it is submitted, not merely that harmonisation per se cannot be an objective but that harmonisation of the regulatory burdens on operators to avoid unequal competition between them and, likewise, harmonisation of the legal rules to ensure a more familiar legal environment for economic operators can *never* provide a basis for harmonisation, even in specific cases where the impact of those kind of legal differences are more significant than others. That is, these particular kinds of regulatory impacts can never be considered to be "such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market". Thus it is not possible to further harmonise public procurement rules solely for the simplicity brought about by standardisation.

Promoting the internal market by requiring the award of contract to the best supplier?

A more difficult question is whether the directives seek not merely to ensure that public contracts are awarded without discrimination and other restrictions on access to the market but that they are awarded to the best tenderer in the sense of the tenderer offering the best value for the procuring entity in pursuit of its commercial and

⁴⁸ Para. 89 of the Opinion.

horizontal procurement objectives⁴⁹. It can be argued that an internal market can only work if public purchasers behave 'efficiently' in choosing the best supplier. The "Invisible Hand" of the market can work to allocate resources effectively, including in international trade, only if purchasers that seek value for money actually do so effectively, as only in these circumstances will the most efficient firms survive and develop, ensuring that the benefits of competition in the market are realised. Whilst commercial pressure ensures that private sector firms obtain their requirements from the most competitive source, this cannot be assumed to be the case with the public sector, even if it does not engage in discriminatory behaviour. Thus, it might be argued, it is necessary to regulate the award of contracts in the public sector to ensure efficient behaviour. Many national legal systems adopt their own legal rules on public procurement to ensure contracts are awarded in this way. From the perspective of national systems, the main reason for such rules is to ensure *value for money* for public bodies to avoid wasting public funds. From the perspective of the EU the main purpose of such rules in the directives would be to ensure public bodies choose the best supplier *in order to develop the internal market*.

This purpose is to some extent consistent with their content of the rules in the directives, which coincides with many of the types of rules commonly adopted in national procurement systems for obtaining value for money – which, as we have seen, itself involves transparency and formal competition for contracts. On the other

⁴⁹ This view of the directives as ensuring that public bodies accept the best offer is also perhaps envisaged by the Commission when it refers to the regime's alleged concern with 'the rational allocation of public money through the choice of the best offer presented': European Commission, *Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM (2001)274 final, p.4. However, even if this view is correct it is still for the procuring entity to determine its own "values" for the purpose: see the discussion later below.

hand, this feature of the transparency rules can equally be explained by the facts that, first, the EU objectives are co-incidentally served by the same tools as national objectives⁵⁰ – in particular, transparency that involves a formal competition – and, secondly, that the directives seek to achieve EU objectives in a manner that is as consistent as possible with national objectives, in accordance with the EU principles of proportionality and subsidiarity. The coincidence of means between EU objectives and national value-for-money objectives, in particular, can easily lead observers to the conclusion that the regulatory systems at the different levels both pursue value for money objectives - but this is not necessarily the case.

Is this objective of ensuring efficient public procurement to ensure effective allocation of resources through the market a lawful and actual function of the EU procurement directives?

The issue is not entirely clear and statements may be found in the jurisprudence of the CJEU to support different views. However, it is submitted, at least, that this is not a function of the current directives.

An argument in favour of this broader function might be found in the fact that the preambles to the current Public Sector Directive adopted in 2004 and to its immediate predecessors refer to the development of *effective* competition, or the opening up of competition, as one purpose of the directives.⁵¹ This might be considered as a

⁵⁰ S.Arrowsmith, "The National and International Perspectives on the Regulation of Public Procurement: Harmony or Conflict?", in *Gospodarka Administracja Samorząd*, ed. H.Olszewskiego and B.Popowskiej (1997), 9-36; also published in S.Arrowsmith and A.Davies (eds.), *Public Procurement Global Revolution*, (Kluwer Law; 1998), 1.

⁵¹ See Directive 93/36/EEC [1993] O.J. L199/1, fourteenth recital and Directive 93/37/EEC [1993] O.J. L199/54, 10th recital, which mention "effective competition" as a reason for certain provisions on notices; Directive 92/50/EEC [1992] O.J. L209/1, 20th recital, stating that an objective

reference to the purpose of the directives themselves as being to ensure that contracts are awarded to the best firms through requiring a competition and regulating the precise *way in which the competition for contracts is conducted*.

However, these references to competition more naturally indicate not this function but other aspects of the directives, including⁵² the fact that they *remove certain restrictions on participation* in the market so that it is opened to potential competition from, in particular, firms from other Member States; and that they require procuring entities to hold a competition *as a means of ensuring transparency to prevent discriminatory behaviour* (which is also an approach consistent with the approach adopted by states to implementing national procurement policy, notably value for money).

is to eliminate practices that restrict competition in general and participation in contracts by other Member States' national in particular; and Directive 2004/18/EC, [2004] O.J. L134/14, recital 2, referring to the opening up of public procurement to competition.

⁵² The reference to competition in pre-ambls of the directives has also been considered as referring to competition policy in the sense of the EU's "competition law" policy of preventing firms that operate in the market from obtaining unfair subsidies or comparable advantages: see Case C-340/04, *Carbotermo SpA and Consorzio Alisei v Comune di Busto Arsizio and AGESP SpA* [2006] ECR I-4137, paras.58-59 of the judgment. This could be justify interpretations that support development of competitive structures in the private market and/or limit the distorting effects that public procurement rules may have on those markets: see further G.S.Oelyyke, "How does the Court of Justice of the European Union pursue competition concerns in a public procurement context?" (2011) 20 P.P.L.R. 179.

The narrower view of the directives is stated very clearly by Advocate General Jacobs in *SIAC Construction*⁵³:

"The main purpose of regulating the award of public contracts in general is to ensure that public funds are spent honestly and efficiently, on the basis of a serious assessment and without any kind of favouritism or *quid pro quo* whether financial or political. *The main purpose of Community harmonisation is to ensure in addition abolition of barriers and a level playing-field by, inter alia, requirements of transparency and objectivity*". (Emphasis in last sentence added.)

This indicates a limited purpose for EU regulation of ensuring abolition of barriers to entry and a level playing-field, *against a backdrop of other - national - rules that are concerned (inter alia) with ensuring efficient expenditure to safeguard public funds*. This "national" purpose of achieving efficient expenditure is specifically differentiated from the purpose of the EU's own rules, and the Advocate General does not see ensuring efficient expenditure as an EU objective.

This view is also effectively supported by CJEU cases that emphasise *only* the purpose of preventing discrimination when interpreting the scope of entities and contracts covered by the Directive⁵⁴.

⁵³ Case C-19/00, *SIAC Construction v County Council of the County of Mayo* [2001] E.C.R. I-7725, para. 33 of the Opinion.

⁵⁴ As stated in Case C-380/98, *R v HM Treasury ex parte University of Cambridge* [2000] ECR I-8035, para.16, cited in many later cases. Some of these later cases refer to avoiding risk of preference *and* the possibility of a body being guided by considerations other than economic ones (e.g., Case C-470/99, *Universale-Bau v EBS* [2002] ECR I-11617, para. 52; Case C-237/99, *Commission v France* [2001] ECR I-939), but it appears that the *Cambridge* case itself, as well as those discussed in the text below, refers to "non-economic considerations" *in the sense of national preference* – and the actual analysis in all the cases focuses on the risk of discrimination.

Thus this was the approach in the *Mannesmann* case in which the CJEU considered whether the concept of a body governed by public law (one of the categories of regulated entity⁵⁵), which does not generally cover entities operating in a commercial market, applies to a body that operates some non-commercial activities even though its activities are predominantly commercial. The Court concluded that such a body is regulated and that this “is explained by the aim of Directive 93/37 to avoid the risk of preference being given to national tenderers or applicants whenever a contract is awarded by contracting authorities”⁵⁶ – the reasoning is that if the directive did *not* apply in such a case then non-commercial activities, which involve a risk of national preference, would be excluded from the directive. In the subsequent case of *BFI Holding* the Court again referred only to this purpose of the directive when considering the scope of entities and activities covered. Thus in considering the relevance to the definition of covered entities of the fact that private undertakings carry on activities similar to the entity concerned the Court stated in paragraph 42:

“...the objective of Directive 92/50 is to avoid the risk of preference being given to national tenderers or applicants whenever a contract is awarded by the contracting authorities (see, to that effect, *Mannesmann Anlagenbau Austria*, cited above, paragraph 33)”.

As regards the relevance of private undertakings carrying on the same activities the Court then immediately went on to conclude in para. 43:

“The fact that there is competition is not sufficient to exclude the possibility that a body financed or controlled by the State, territorial authorities or other bodies governed by public law may choose to be guided by other than economic considerations. Thus, for example, such a body might consider it

⁵⁵ Defined currently in Article 1(9) of Directive 2004/18.

⁵⁶ C-44/96, *Mannesmann Anlagenbau Austria AG v Strohal Rotationsdruck GesmbH* [1998] E.C.R. I-73, para. 33.

appropriate to incur financial losses in order to follow a particular purchasing policy of the body upon which it is closely dependent.

On this basis the Court concluded that the *mere fact* that activities are also carried on by private undertakings does not make them non-commercial. It is notable that in paragraphs 42-43 the possibility of an entity being guided by non-economic considerations appears to be equated wholly with the possibility of an entity being guided by national preference, and the need to avoid national preference is the sole focus of the judgment- the reference to non-economic considerations in paragraph 43 refers back to the preference mention in paragraph 32. Significantly, the Court in these cases did not consider in addressing the various questions that arose what conclusion might be indicated by the need to ensure awards are made to the best tenderer. It might be argued that the latter consideration, if relevant, would actually suggest the opposite conclusion to that reached by the Court in *BFI Holding*, on the basis that market disciplines provide a more effective means than regulation of ensuring value for money, and that this objective is better achieved overall by allowing the market, rather than regulatory rules, to do this work where a market exists. The reasoning in these cases thus tends to support that ensuring the award is made to the best tenderer is not considered an objective of the directives.

Further, the function of “competition” as *supporting* non-discrimination rules has been stated by the Court of Justice in several cases. Thus, for example, in the *La Scala* case⁵⁷ the Court stated:

⁵⁷ Case C-399/98, *Ordine degli Architetti delle province de Milano e Lodi v Comune di Milano* (“*La Scala*”) [2001] E.C.R. I-5409, cited also in, for example, Joined cases C-285/99 and C-286/99, *Impresa Lombardini SpA v ANAS* [2001] E.C.R. I-9233, para. 34, referring to this as the “primary aim” of the relevant directive. See also Case C-92/00, *Hospital Ingenieure Krankenhaustechnik Planungs- GmbH (HI) v Stadt Wien* [2002] E.C.R. I-5553, para. 44, and Case C-507/03, *Commission v Ireland* (“*An Post*”) [2007] ECR I-9777, para.47, also

“The interpretation of the directive adopted] is consistent with the basic aim of the Directive which, as stated in paragraph 52 above, is to open up public works contracts to competition. Exposure to Community competition in accordance with the procedures provided for by the Directive *ensures that the public authorities cannot indulge in favouritism.*” (Emphasis added).

That the directives *merely* seek to prevent discrimination and to remove restrictions on obtaining access to the market, and do not have any further aim of securing the award of contracts for the best tenderer, is strongly reflected in the limited rules of the directives. They do not contain regulatory rules on many issues which are regulated in national procurement systems for the purpose of ensuring value for money but which do *not* relate to transparency or access to the market. For example, there are no rules concerning the type of award procedures, or the specific award criteria, that are most suitable for different types of contract (for example, governing the choice between open or restricted tendering in different situations). The rules on abnormally low tenders provide another good, and more specific, example, of the limited focus of the directives’ rules: these explicitly prohibit entities from rejecting apparently unsustainable tenders without investigating whether there is a good reason for the low price⁵⁸, aimed in particular to ensure that tenderers from countries with lower costs are not rejected when their tenders are low for that reason; but there are no explicit rules comparable to those found in some national systems for

taking an apparently limited view of the directives as removing practices that restrict competition by improving access to award procedures; and Case C-213/07, *Michaniki AE v Ethniko Simvoulío Raidotileorasis and Ypourgos Epikrateias* [2008] ECR I-9999, para. 53, stating also that the “primary aim” of the directive is to prevent entities indulging in favouritism.

⁵⁸ As in Directive 2004/18 Article 55.

reasons of ensuring value for money that *require* procuring entities to consider whether bids are unsustainable and to consider rejection where that is the case. Of course, the limited content of the directives when compared with national systems could be explained by the fact that even were the directives to aim in principle at ensuring that awards are made to the best supplier it would be appropriate to leave a broad discretion to Member States on how this it to be achieved within their national systems in accordance with EU principles of proportionality and subsidiarity, including to take into account the different circumstances of different countries that are relevant to this issue, that we have discussed above. However, it is striking that the overwhelming focus of the rules contained in the directives is on transparency issues and at limiting restrictions on entry to the market, as opposed to the other areas typically regulated by national procurement rules to secure value for money. It is also significant that the directives apply only to contracts large enough to be considered of interest for direct cross-border trade – there would be no reason for such a limitation if the rules were intended to ensure that contracts were awarded to the most efficient firms.

A broader view of the directives, however, is also found in the jurisprudence. This is perhaps articulated in *Sintesi*⁵⁹. In this case the Court supported its conclusions that Member States may not require entities to award all works contracts on the basis of lowest price, because:

“the abstract and general fixing by the national legislature of a single criterion for the award of public works contracts deprives the contracting authorities of the possibility of taking into consideration the nature and specific characteristics of such contracts, taken in isolation, by choosing for

⁵⁹ Case C-247/02, *Sintesi SpA v Autorità per la Vigilanza sui Lavori Pubblici* [2005] 1 C.M.L.R. 12 para. 40. See also para.14 of the Opinion, stating that free movement and free competition are distinct objectives.

each of them the criterion most likely to ensure free competition and thus to ensure that the best tender will be accepted”⁶⁰.

This seems to suggest that the directives’ aim *is* to ensure that the best supplier is selected. The fact that the directives require procuring entities to selecting the lowest-priced or most economically advantageous tender⁶¹ might also seem to support such a view⁶². However, this rule can alternatively be explained as one that is designed to secure the transparency that helps eliminate national favouritism, by applying a stated framework for decision-making on the award, with the framework chosen being one which is acceptable to all Member States. Since Member States themselves, in pursuing their own objectives such as value for money, choose to use the approach of selecting the best tender when awarding their contracts⁶³, this is an appropriate framework to use for transparency purposes in the directive.

In the author’s view, the broad interpretation of the directives’ objectives as being concerned, in addition to other matters, with ensuring the award of the contract to the best available supplier, is not correct: both the explicit contents of the directives and their historical evolution, as outlined above, are more consistent with the narrower conception of the role of the directives as merely moving barriers to participation in the market and to prevent discrimination. Thus the jurisprudence that supports this narrower conception is to be preferred. However, it must be acknowledged that the position is

⁶⁰ *Sintesi*, note 59 above, para. 40 of the judgment.

⁶¹ Directive 2004/18 Article 53.

⁶² This seems to be the conclusion of the CJEU in Joined Cases C-147-148/06, *SECAP and Santorso v Comuni di Torino* [2008] ECR I-3565, paras. 6 and 29, thus apparently also supporting the view that this is function of the directives.

⁶³ This is not to say that there is not controversy over the meaning of the provision, and the purpose of the directives seems relevant to resolving this, as is discussed below.

not entirely clear, and the regulation of procurement to ensure awards to the best supplier is probably consistent with the legal basis on which the directives were adopted.

Whether the broad or narrow view of the aim of the procurement directives is the correct one may be of some importance for interpreting – and developing – the rules. This is evident in the discussion of the cases of the CJEU that have already been considered above. Thus, for example, we suggested that the outcome of the *Mannesmann* case might have been different had the directives been considered as an instrument to ensure selection of the best contractor.

This can be illustrated by reference to the issue of choice of award procedures. In this respect, as we have seen, the Public Sector Directive currently provides for Member States to choose freely between use of open and restricted procedures, taking the view that the restricted procedure provides sufficient transparency to promote EU objectives through the means of deterring and monitoring discriminatory behaviour. Suppose, however, the EU were to take the view that although the restricted procedure provides adequate transparency for this purpose it does not allow for choosing the best tenderer in the market for some specific products and services because there is a wide variation between offers of market participants and restricting the number of tenderers in these markets often prevents participation by those who could make the best offers. If the view is taken that the directive aims to ensure the best tenderers are chosen then the EU could justify requiring use of open procedures for this reason. However, if that is not the case then in deciding whether to make open procedures mandatory this concern could not be taken into account. Conversely, suppose that the EU is of the view that use of open procedures actually deters the best tenderers from participating in certain markets, and that restricted procedures should be mandatory for some types of procurement for this reason. This can only be a relevant consideration to restrict

access to open procedures by the directives if it is the aim of the directives to ensure that contracts are given to the best tenderer.

Similarly, a *requirement* in the directives for procuring entities to reject unsustainable tenders – which we explained above does not exist at present – could not be introduced if the function of the directives is limited to preventing discrimination and removing barriers to access, but could possibly be included if one of their functions is to secure the award for the best supplier.

4.3.3 Value for money and its relationship with the procurement directives

The place of value for money in the EU regulatory system: general principles

We can now turn to the relationship between the rules in the directives and the objective of value for money in acquiring goods, works and services, which we have seen in section 4.2 is the most prominent objective of most national procurement systems.

As mentioned in the introduction, this relationship has sometimes been a source of confusion. In particular, it has sometimes been suggested that the directives regulate public procurement in the Member States in order to secure value for money for taxpayers. This is a claim that has occasionally been made by the European Commission, including in the recent Green Paper on modernising the procurement directives⁶⁴, and which appears to be suggested

⁶⁴ European Commission, note 45 above, p.39, suggesting as the first reason for not relaxing the directives' restrictions on policies that do not relate to the subject matter of a contract (a point discussed further below) that "This is an important guarantee to ensure that contracting authorities obtain the best possible offer with efficient use of public monies".

even in one of the recitals to the directives⁶⁵. It has also been referred to in the occasional Advocate General's Opinion⁶⁶, although it does not - to the knowledge of the author - find any support in the judgments of the CJEU itself. It is submitted, however, that the directives do not address the general issue of value for money. Most significantly, the internal market provisions on which the directives are based *do not in fact confer a power to regulate for this reason*.

In this respect the CJEU has made it very clear that, pursuant to their objective of creating an internal market in the EU, these internal market provisions may be invoked by the EU legislature only for two purposes that relate to the internal market. These purposes are to support the "four freedoms" (the free movement of goods, services, capital and persons) and to seek to eliminate appreciable distortions of competition in the market⁶⁷. As Advocate General Fennelly emphasised in his Opinion in the *First Tobacco Case* "the internal

⁶⁵ Recitals 5 and 12 respectively of Directive 2004/18 and Directive 2004/17/EC. The former, for example, states: "This Directive therefore clarifies how the contracting authorities may contribute to the protection of the environment and the promotion of sustainable development, whilst ensuring the possibility of obtaining the best value for money for their contracts". This implies that the latter is a purpose of the directives (rather than - as argued below - a matter for Member States that the directives must take into account). See the discussion below in section 4.3.3.

⁶⁶ Case C-450/06, *Varec v Belgian State* [2008] ECR I-581, para. 33 of the Opinion of Advocate General Sharpston, relying on the statement of Advocate General Jacobs in *SIAC* that was cited in section 3 but, however, quoting this out of context in a way that suggests that statement was referring to the objectives of the EU directives rather than public procurement regulation "in general"; and Case C-250/07, *Commission v Greece* [2009] ECR I-4369, paras.11-12 of the Opinion of Advocate General Poiares Maduro (although it might be possible to interpret the references to value for money as referring to an incidental benefit, rather than an objective of the rules).

⁶⁷ Case C-376/98, *Germany v Parliament and Council* [2000] E.C.R. I-8419.

market is not a value-free synonym for general economic governance"⁶⁸. It seems very clear that the goal of ensuring careful expenditure of public money is a matter of economic governance that does not fall within the specific purposes of the internal market provisions. More efficient expenditure is certainly a benefit to government *that flows from* the creation of an internal market, including from the rules on public procurement that contribute to that internal market in the ways discussed in section 4.3.2 above. These benefits include, amongst others, savings for government from lower prices or better products and services, obtained both from foreign suppliers and from domestic suppliers that are now subject to foreign competition, and access to cheaper and better products and services that result from restructuring effects (benefits which also apply to the private sector)⁶⁹. However, the converse relationship does not apply – saving public expenditure in general does not per se *contribute to* the creation of an internal market⁷⁰. Thus it is clear, for example, the EU could not under the internal market provisions require Member States to cut back on social programmes

⁶⁸ Case C-376/98, above, para. 85 of the Opinion.

⁶⁹ On these anticipated benefits see W.S. Atkins Management Consultants, *The Cost of Non-Europe in Public Procurement* (1988) (hereafter the Atkins study), vol. 5A; and for the most recent evaluation of the results of EU procurement policy European Commission, Commission Staff Working Paper, *Evaluation Report: Impact and Effectiveness of EU Public Procurement Legislation* SEC(2011) 853 final, at http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/evaluation-report_en.pdf. Improved value for money for public purchasers will also follow from many other aspects of single market policy, such as policies directed at technical regulations in products purchased by the public sector.

⁷⁰ S. Arrowsmith and P. Kunzlik (eds), "Public Procurement and Horizontal Policies in EC Law: General Principles", Ch.1 in *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (CUP, 2009), p.33.

that are shown to be ineffective in producing social benefits, in order to prevent national governments from wasted expenditure; nor could it under these provisions regulate the employment practices of Member States to avoid inefficient conduct (such as excessive payments or benefits, or failure to monitor attendance of civil servants), and hence wasted expenditure. These matters have nothing to do with creating an internal market. In precisely the same way, the objective of saving money for Member State governments also cannot *per se* provide a reason to regulate their procurement procedures under the internal market provisions. The EU institutions must look elsewhere in the EU Treaties for any limited powers that they have to act in such matters. Likewise, policies that aim at ensuring quality in the goods and services provided to government and, through government action, directly to citizens – which is also an aspect of ensuring value for money in public procurement as we have defined it – also do not find any basis in the internal market on which the procurement directives are based (although again they may be a result that flows from the creation of an internal market).

What is clear, on the other hand, is that in adopting measures on public procurement directed at the creation of an internal market, the EU legislature must take into account the interests of Member States in promoting their own procurement objectives, and these include, most obviously, the interest that Member States themselves have in securing value for money, as well as other interests such as reducing procedural costs and promoting national social objectives. It is important to note in this respect that under the principle of proportionality stated in Article 5 TFEU, the content and form of Union action must not exceed what is necessary to achieve the objectives of the Treaties, which entails that if these objectives can be obtained by means that are less restrictive of the interests of Member States these less restrictive approaches must be followed. This is relevant both for developing the directives and for interpreting the directives.

As regards Member States' interests in pursuing value for money, it is important to reiterate the point made earlier that, in light of their own circumstances (such as levels of corruption) and also the way in which they balance value for money and other national procurement objectives, states may differ in the way in which they choose to ensure value for money. They may differ, *inter alia*, in the emphasis given to transparency as a means to promote this objective and, in particular, the role played by discretionary decision-making of procurement officers in the national procurement system. Given the emphasis that the EU system places on transparency as a means to achieve its internal market objectives⁷¹, there is significant potential for conflict on this point between transparency measures put in place under the EU rules and the approach that Member States may wish to adopt to pursue their national procurement objectives⁷². To give just one simple example that has been of concern in the directives, significant scope for negotiations with suppliers may be perceived as essential by some Member States to ensure value for money in awarding certain contracts, but EU law has considered it appropriate to limit negotiation under the directives because of a concern that negotiations can be abused to favour national suppliers (for example, by passing them information on other tenders or allowing them opportunities for improving tenders that are not given to other suppliers)⁷³. The perception that there was insufficient scope for negotiation for certain types of contracts awarded by public

⁷¹ This should not be taken to indicate that the current emphasis on transparency is appropriate to achieve EU objectives; in fact, the present author considers that it is not.

⁷² See S. Arrowsmith, "The EC Procurement Directives, National Procurement Policies and Better Governance: The Case for a New Approach" (2002) 27 *European Law Review* 3.

⁷³ For detailed analysis of these points see S. Arrowsmith and S. Treumer, "Competitive Dialogue in EU Law: a Critical Review", ch.1 in Arrowsmith and Treumer, note 43 above.

bodies led to the inclusion in Directive 2004/18 led to the addition of the new competitive dialogue procedure. Interpretation of the grey areas of this procedure, however, both in terms of the precise scope for negotiation at different stages and on other matters, such as the scope of the procedure and flexibility on other issues (such as changing award criteria), still presents many such potential conflicts between transparency and discretion. Such potential conflicts must be resolved in light of the proportionality principle, including by taking into account different national circumstances.

Practical consequences of the general principles

In light of these principles, what is the practical significance of the above contention that value for money is not per se a subject of regulation under the procurement directives?

First, it is clear that the significance of this point depends to some degree on whether or not the directives seek to ensure the award of a contract to the best supplier available as a means for achieving an internal market – a point which we suggested in section 4.3.2 is not entirely clear. If this is indeed a function of the directives the scope and potential scope of their regulatory rules may in any case cover much of the ground for regulating the way in which procurement processes are conducted, which might otherwise be left to Member States themselves in pursuit of best value for money. This is because best value for money itself depends to a significant degree on ensuring that the best supplier is identified. If the EU regulates the latter in principle, it excludes the possibility for Member States to regulate this particular aspect of obtaining value for money in the way that they consider most appropriate, except within the parameters of the rules already set on this point by the EU. Of course, the space for Member States to regulate to achieve best value in their own way is limited significantly in any case by the transparency rules that seek to prevent discrimination and rules that seek to remove barriers to market access. Thus, as we have

mentioned, in the name of transparency the directives currently restrict the scope for negotiation in tendering procedures, precluding negotiation in some cases in which some Member States may regard this as beneficial from a value for money perspective. However, an additional aspect of the directives of securing selection of the best available supplier potentially extends regulation even further and more deeply into areas that are potentially of interest to Member States for value for money reasons. Thus, as we mentioned above, this concern could, for example, justify more extensive EU-level regulation of the grounds for using particular award procedures or of the treatment of unsustainable tenders.

However, even if the directives do seek to ensure contracts are awarded to the best tenderer, there still appears to be more space for Member States to adopt their own rules and procedures to obtain best value for money than if achieving value for money were per se a function of the EU procurement rules.

This may be illustrated by considering the issue of discussions with the winning tenderer in open or restricted procedures, and specifically the question of whether a contracting authority may negotiate with the winning tenderer to seek improvements to the tenderer's offer, such as a lower price. There are two key reasons why such conduct may be detrimental to the value for money objectives of contracting authorities. One is that that it may lead tenderers to accept unsustainably low prices (leading to problems such as failure of the contract or cutting corners on quality). The other that if there is an expectation that this will happen tenders may decide not to submit their best bids in the tendering stage. Nevertheless, it may be possible to obtain significant and sustainable improvements in bids by allowing this in certain cases. Based on these considerations, and their different situations (such as the training of procurement officials), from a value for money perspective states may prefer different approaches to this issue: they may, for example, prefer to prohibit the practice altogether, they may think it best to leave the issue to their contracting authorities to deal

with on a case by case basis, or they may prefer to allow the practice but only in defined cases. How far are such different approaches towards value for money permitted under the Public Sector Directive? The directive does not contain explicit rules on post-tender negotiations in open and restricted procedures, and it is necessary to look to the general principles of the directive, interpreted in light, *inter alia*, of its objectives, to resolve this question of whether the directive allows negotiations to improve the winning tender.

In this respect, it appears that the principles of equal treatment and transparency preclude, as a general rule, the possibility of post-tender negotiations with tenderers to allow them to improve their tenders⁷⁴. As we have mentioned above, a possible justification for this under EU law is the potential for the abuse of such negotiations to favour national suppliers to enhance their chances of being selected as the winning tenderer: this reflects the directive's function of imposing transparency for the purpose of preventing and monitoring discrimination. However, this consideration does not apply in the same way once the winning tenderer has been chosen: after this point there is no scope for discrimination that can affect the choice of tenderer. The consideration of preventing discrimination can justify prohibiting negotiations that lead to terms that are more *favourable* to the tenderer, since allowing such negotiations effectively enables the parties to evade the transparency rules that have governed the award of the contract, and potentially allows national suppliers to submit favourable offers to win the contract in the expectation that these offers will be revised at a later point. Thus negotiations of that kind would appear to be prohibited, whether

⁷⁴ Case C-243/89, *Commission v Denmark* ("Storebaelt") [1993] ECR I-3353 (negotiations with one tenderer only); *Council and Commission Statement concerning Article 7(4) of Public Works Directive 93/37* [1994] O.J. L111/114; and see Arrowsmith (ed.), note 1 above, chapter 6, section 6.9; and in more detail Arrowsmith, note 30 above, pp.540-545.

they occur before or after the actual conclusion of the contract⁷⁵. However, these considerations do not apply to negotiations resulting in terms that are *less favourable* to the contractor. Thus it cannot simply be assumed that the “rule” against post-tender negotiations covers negotiations to improve a tender that has already been chosen as the winning tender.

Might, however, other considerations still justify interpreting the directive as precluding such negotiations? It in fact seems difficult to argue that this is the case. This is difficult even if the directives are aimed at ensuring the award is made to the best tenderer, since the winning tender has already been selected at this point. The arguments set out above against such a practice are arguments based solely on value for money – and if this is not per se an objective of the directive, it cannot justify any rule prohibiting such negotiations: assessing the merits of the various arguments concerning value for money and how to give effect to them remains a matter for Member States. The main possible argument for a rule controlling such negotiations would be that the best suppliers in the market will not participate if the conduct of the procedure may push them towards submitting unsustainable offers. However, this is a rather tenuous argument, especially to the extent that Member States policies might allow use of such negotiations only in limited cases and with caution.

Another important illustration of the limited role of EU regulation concerns the relationship between the value for money objectives of procurement, in the sense of ensuring that the subject matter of the procurement is supplied on the best possible terms, and the horizontal objectives of public procurement⁷⁶. Given that value

⁷⁵ In the case of *presstext* the CJEU indicated that this is the case for post-contract changes, which are ruled out if they alter the “economic balance” of the contract in favour of the contractor (Case C-454/06, *Presstext Nachrichtenagentur v Austria* [2008] ECR I-4401).

⁷⁶ And, of course, the balance between value for money and other objectives, such as limiting the costs of the procurement process.

for money in this sense is itself for Member States to address, it is clear that the balance to be made between this objective and the implementation of horizontal policies in procurement is also, as a starting point, a matter for Member States. Thus it is quite clear that it is in principle for Member States to determine, for example, the respective weighting to be given to horizontal criteria and “commercial” criteria, such as price and product quality, when both are used as award criteria. This has been recognised as the case under the current directives in the *EVN* case⁷⁷ (in which the court considered it open to Member States to apply a 45% weighting to environmental award criteria). It also seems clear that in the absence of any possibility under the internal market provisions of regulating value for money per se, these provisions cannot generally be used to limit the possibilities for Member States to pursue horizontal policies through procurement simply because the EU regards these as too costly in light of their benefits, and thus as detrimental to value for money (although limits could, of course – and are⁷⁸ – be imposed on horizontal policies for other reasons, such as their impact as barriers to participation in the market, and the potential for abuse of discretion to favour national suppliers in operating such policies). It can be noted that in the 2011 Green Paper on modernising public procurement policy the Commission purports to justify the current rule that horizontal policy measures must relate to the subject matter of the contract on the following basis (inter alia):

“The link with the subject-matter of the contract ensures that the purchase itself remains central to the process in which taxpayers' money is used. This is an important guarantee to ensure that contracting authorities obtain the

⁷⁷ Case C-448/01, *EVN AG and Wienstrom GmbH v Austria* [2003] ECR I-14527.

⁷⁸ See generally Arrowsmith and Kunzlik, note 17 above; C. McCrudden, *Buying Social Justice: Equality, Government Procurement, & Legal Change* (OUP, 2007); R. Caranta and M. Trybus (eds), *The Law of Green and Social Procurement in Europe* (Copenhagen: Djøf Publishing, 2010).

best possible offer with efficient use of public monies. As explained above, this objective is also highlighted in the Europe 2020 strategy, which stresses that public procurement policy must ensure the most efficient use of public funds.⁷⁹

In light of the rules just mentioned, however, it seems clear that the current limit cannot be justified by reference to this consideration. In a similar vein, recital 5 of the Public Sector Directive states that the directive:

“.. clarifies how the contracting authorities may contribute to the protection of the environment and the promotion of sustainable development, whilst ensuring the possibility of obtaining the best value for money for their contracts”.

Again, to the extent that this suggests that provisions in the directive limits procurement measures that promote environmental goals in order to avoid waste of national public funds, this cannot be a correct characterisation of the purpose of the relevant provisions.

This is not to say that there are not some limits on this principle that the balance between value for money in our sense and horizontal policies in procurement are in principle for Member States. Thus *to the extent that the EU itself has the legal competence under the Treaty to regulate to promote social and environmental objectives* it may require Member States to use their procurement for such purposes, and indeed has done so through a number of measures⁸⁰;

⁷⁹ European Commission, note 45 above.

⁸⁰ See, for example, Article 45 of Directive 2004/18 (obligation for certain regulated purchasers to exclude firms that have convictions for corruption, certain types of fraud, money-laundering or participation in a criminal organisation; Article 23(1) of Directive 2004/18 stating that ‘whenever possible’ technical specifications should take into account accessibility criteria for people with disabilities or design for all users; Article 23(1); Directive 2005/32/EC on Energy End-use and Energy Services (OJ 2005 No. L191/29) obliging Member States to take account of energy efficiency in procurement; and Directive 2009/33/EC on promoting clean, energy-

and it is possible to argue⁸¹ also that it has a power to harmonise the specifications used for specific products or services in public procurement in order to remove barriers to access, which would arguably give some power to restrict both the “commercial” requirements or criteria and the horizontal requirements or criteria laid down by Member States. However, it is clear that the internal market provisions do not justify EU intervention to limit the power to implement horizontal policy measures out of consideration for value money and efficiency in public expenditure, and that the directives can neither be interpreted nor developed to this end under those provisions.

We can see therefore, that the discretion available to Member States under the procurement directives, including to secure value for money in their procurement, depends to some degree on precisely what are the means employed by those directives to achieve the goal of a single market - in particular, if those means include ensuring the award of contracts to the best available suppliers, that discretion will potentially be less than it would be if that were not a function pursued by the directives. However, whatever means the directives do use towards the single market goal, it is clear that achieving best value for money is not per se one of their functions, and that that fact means that some areas of procurement policy are outside the scope of regulation under the directives.

efficient road vehicles (OJ 2009, L120/5) which imposes certain obligations to take into account environmental matters when purchasing vehicles.

⁸¹ However, the question can be raised as to why a distinction should be made between public sector and private sector activity as regards the exercise of such a power to control purchaser autonomy – that is to control *what* is purchased as opposed to how it is purchased.

In addition, the extent of the discretion actually or potentially afforded to Member States will depend not only on the functions of the directives but also, crucially, on the precise way in which the EU regulators and judiciary, when giving effect to the relevant functions of the directives, have regard to the interests of Member States in obtaining value for money in the way most suitable to their own situations. As we have seen, law-makers must take account of these interests, and must have regard to the proportionality principle when doing so, in exercising their own powers. Given the very wide area that is potentially covered by the accepted functions of the directives – indeed by the function of promoting non-discrimination through transparency alone – this is also a very important issue in delimiting the discretion of Member States. In this respect it is essential to recognise, as we have set out above, that it cannot be assumed that transparency rules that are aimed at promoting the single market will automatically promote Member States' own interests in value for money: there is a significant potential for conflict. Also important is the fact mentioned above that the approach of Member States to this subject may legitimately vary according to their own circumstances. In the author's view this variation in the situation of Member States is a significant factor to be taken into account. Further, this approach is supported by recital 3 to the Public Sector Directive (reiterating a principle stated also in recitals to previous procurement directives)⁸² that the directive's provisions "should comply as far as possible with current procedures and practices in each of the Member States".

⁸² Directive 93/36, 1993] O.J. L199/1 recital 6 and Directive 93/37, [1993] O.J. L199/54 recital 3.

4.4 Proposals for reform

4.4.1 Introduction

In this final section we will set out some proposals for reform of the current procurement directives. It is submitted that the approach set out below will ensure a real simplification of the “Frankenstein’s monster” that is the current procurement directives. It will also provide for the greater flexibility for Member States that is recognised as one of the objectives of the current reform programme, and which, it is submitted, is needed to provide a better balance between the directives’ objective of promoting a single market and Member States’ interests in regulating public procurement. Fundamental to this balance is the important point elaborated above that it is not an objective of the directives to ensure value for money in procurement: as we have seen this remains a matter for Member States, and the single market measures adopted by the EU must take account of Member States’ interests in this area, as well as others, in accordance with the principle of proportionality. In this respect, it must be remembered that, as elaborated above, transparency rules at EU level may inhibit limit the ability of Member States to pursue value for money in accordance with their own preferences and circumstances. The proposals made also take into account the author’s view that, whilst a degree of transparency is certainly useful, there are also significant limits on the value of transparency – and, in particular, of very detailed transparency rules that limit the discretion of procuring entities – as a tool for achieving the single market objectives themselves⁸³.

The author has previously suggested a more radical reform of the directives than is proposed here, whereby procurement in Member States would be regulated only by the need to comply with

⁸³ See Arrowsmith, “The EC Procurement Directives...”, note 20 above.

the general principles of the Treaty on non-discrimination and transparency, rather than through specific transparency rules, using a new approach to enforcement and evaluation to secure adherence to the Treaty principles⁸⁴. In the author's view, this remains preferable. However, it is recognised that such an approach is politically much more difficult to achieve than one which accepts the basic approach of the current directives and focuses merely on reforming their contents. Thus the present chapter focuses on how to achieve simplification and flexibility within the broad parameters of the existing approach to regulation⁸⁵.

4.4.2 The basic principle: a single directive based on the current Utilities Directive

Introduction

It is submitted that the starting point for any reform should be to consolidate all three of the substantive directives – the Public Sector Directive, Utilities Directive, and Defence and Security Directive – into one single directive, the contents of which would be based on the current Utilities Directive. This single directive would be applied in principle to all entities and activities covered by the current directives.

A single directive of this kind would also be entirely suitable for regulating the award of concession contracts, including services concessions that are currently excluded from the procurement directives. Thus it would not be necessary to introduce an entirely

⁸⁴ Arrowsmith, "The EC Procurement Directives...", note 20 above.

⁸⁵ In this respect the chapter updates and develops the view put forward briefly in Arrowsmith, "The EC Procurement Directives...", note 20 above, as to how this might be done as an alternative to a regulatory system based on principles.

new instrument to regulate concessions, but simply to amend the current rules that apply to utilities regarding the extent and manner of their application to concessions.

It is suggested also that there should be a single set of rules on remedies, applying to all award procedures covered by the single substantive directive.

Such a reform would improve flexibility and bring about very considerable simplification of the rules- thus effectively promoting the two main goals of the current reform programme - and also have the advantage of removing anomalies from the regime.

Flexibility

The change proposed above would, first, achieve the *flexibility* goal of the current reform programme, specifically by giving much greater flexibility for contracts currently covered by the general Public Sector Directive.

In this respect it would, first, provide for more flexibility for Member States to pursue value for money objectives in the way best suited to their own situation. This is because the current Utilities Directive does not impose such significant limitations as the other directives on the discretion in decision-making that may be given by Member States to their procuring entities and officers, and because it allows use of procurement tools that are generally prohibited for the public sector because of their perceived impact on market access.

As regards the first point, the Utilities Directive allows, in particular, a free choice over whether to use the open procedure, restricted procedure and negotiated procedure with a notice⁸⁶, the last permitting a general freedom to negotiate with suppliers, subject to the principle of equal treatment⁸⁷. As we have noted above,

⁸⁶ Utilities Directive 2004/17, Article 40.

⁸⁷ On this procedure see Arrowsmith, note 30 above, chapter 16.

negotiations can potentially help ensure value for money for various reasons; and adopting this approach for all regulated procurement would enable Member States to provide for the possibilities of negotiation for their own procuring entities in all situations in which they consider that this is useful. (It also gives Member States the possibility to remove the uncertainty that applies in the current Public Sector Directive over when negotiations are possible, which arises both from the uncertainty over when the negotiated procedure and competitive dialogue are available⁸⁸, and the uncertainty over the extent to which negotiations are permitted in the different procedures⁸⁹). The Utilities Directive also seems to allow more useful flexibility to Member States in drawing up criteria for choosing which firms are to be invited to tender (relevant for restricted and negotiated procedures) when there are more firms meeting the

⁸⁸ On negotiated procedures in this respect see Arrowsmith (ed.), note 1 above, section 6.11 and on competitive dialogue Arrowsmith and Treumer (eds.), note 4, chapter 1, section 4; Arrowsmith, note 30 above, pp.632-635; S. Treumer, "The Field of Application of Competitive Dialogue" (2006) 15 P.P.L.R. 307; A. Brown, "The Impact of the New Directive on Large Infrastructure Projects: Competitive Dialogue or Better the Devil You Know?" (2004) 13 P.P.L.R. 160; M. Burnett, 'Developing a Complexity test for the Use of Competitive Dialogue for PPP Contracts (2010) 4 E.P.P.P.L. (2010) 215.

⁸⁹ On pre-tender negotiations in open and restricted procedures see S. Treumer "Technical Dialogue and the Principle of Equal Treatment – Dealing with Conflicts of Interest after Fabricom" (2007) 16 *Public Procurement Law Review* 99; S. Treumer, "Technical Dialogue Prior to Submission of Tenders and the Principle of Equal Treatment of Tenderers" (1999) 8 *Public Procurement Law Review* 147. On post-tender negotiations in these procedures see the works cited in note 74 above; and on post-tender negotiations in competitive dialogue Arrowsmith and Treumer (eds.), note 4, chapter 1, section 5.

qualification (“suitability”) criteria for participation than the procuring entity wishes to invite⁹⁰.

As regards the second point, unlike the Public Sector Directive, the Utilities Directive allows, in particular, the use of general notices and notices of qualification systems to advertise a procurement, rather than requiring a notice of each specific procurement⁹¹, which can reduce the costs of procurement. It also, very significantly, allows use of mandatory “qualification systems” (that is, it allows access to procurements to be restricted to those on qualification systems), provided that certain rigorous conditions are observed regarding transparency (in various aspects) of the systems⁹². Qualification systems can be very valuable both in enhancing value for money (for example, by allowing procuring entities to work closely with its best suppliers to improve products and services) and reducing costs and delays in procurement⁹³. It should be stressed that it would be for Member States themselves to make the choice of whether or not to allow their entities use of these new flexibilities, taking account of their own circumstances.

Applying a utilities-type regime more broadly would also potentially remove other unjustified limitations that might be interpreted as applying in the extensive (and rather ambiguous)

⁹⁰ The main requirement is for selection to be based on objective rules and criteria, stated in Article 54. However, there are uncertainties over what this means in the context of this directive: see, in detail, S. Arrowsmith and C. Maund, “CSR in the Utilities Sector and the Implications of EC Procurement Policy: A Framework for Debate”, ch.11 in S. Arrowsmith and P. Kunzlik (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (Cambridge: CUP, 2009) 436.

⁹¹ Utilities Directive Article 42.

⁹² Utilities Directive Article 53.

⁹³ On the benefits and costs of these systems see S. Arrowsmith, *Government Procurement in the WTO* (2003, London: Kluwer Law International), pp. 232-236.

provisions of the Public Sector Directive. An example of this can be seen by referring to the explicit and exhaustive⁹⁴ list of evidence in Article 48(2) of that directive that may be demanded of economic operators. The concept of a closed list of permitted evidence is of limited value. However, the list may, on the other hand, make it difficult for contracting authorities to seek evidence of certain matters that are in fact relevant and appropriate for assessing technical ability to perform the contract, unless (which is not clear) Article 48(5) allowing the evaluation of "skills, efficiency, experience and reliability" for certain operations can be interpreted as overriding the need for evidence called for to fall within the explicit list. The main value of removing such provisions, as discussed below, would be its value to simplification, but it might also remove some unjustified obstacles to obtaining value for money.

We can note that the Defence and Security Directive already provides for some of the flexibility offered by the Utilities Directive, notably in the possibility it gives, like the Utilities Directive, for use of the negotiated procedure with a notice for any procurement⁹⁵. However, it does not provide for other important flexibilities, notably the flexible methods of advertising and the use of mandatory qualification systems. The latter, it is submitted, could be of particular value in the defence sector: they provide the best opportunity for thorough assessment of supplier capability (including on security matters) within an adequate time scale, rather than requiring this to be fitted within the timescales of each specific procurement; and they also provide a means for contracting

⁹⁴ The exhaustive nature of the list was established in Case 76/81, S.A. *Transporoute et Travaux v Minister of Public Works* [1982] ECR 417 and *Joined Cases 27-29/86, S.A. Construction et Entreprises Industrielles (CEI) and others v Société Coopérative "Association Intercommunales pour les Autoroutes des Ardennes" and others ("CEI and Bellini")* [1987] ECR 3347.

⁹⁵ Defence and Security Directive, Article 25.

authorities to work closely with their best suppliers to encourage development and innovation, as has happened in the utilities sector.

In addition, applying the rules of the utilities regime to procurement governed by this directive would also improve the rules on use of an open form of tendering for contracts currently covered by that directive, in the sense of a procedure that gives all interested and qualified firms a chance of winning the contract based on a tender. The open procedure that is found in the Public Sector and the Utilities Directive was not been included at all in the Defence and Security Directive, apparently because it was considered unsuitable for defence and security procurement. However, as Heuninckx has argued⁹⁶, this is far from the case, in that there may at least some cases in which the number of potential tenderers is limited and the procuring entity prefers to invite all those who are capable of tendering. Further, a procuring entity might prefer to use an open procedure to encourage participation by suppliers who might fear abuse of the selection stage if a negotiated or restricted procedure were used. It seems rather surprising that the Defence and Security Directive does not explicitly include a procedure that might be useful in some cases for Member States to obtain value for money and which also is the most transparent in the directives, given the emphasis that the directives generally place on transparency as a means to achieve the objectives of the single market. An open-type procedure can be achieved by using a restricted procedure in which the procuring entity indicates in advance that it will consider all those interested who meet the suitability criteria and will not further reduce numbers by inviting only some of those to tender. However, such an approach would still differ from the open procedure of the directives in that it would in principle probably require attention of suitability prior to tendering⁹⁷ (unlike the open procedure which

⁹⁶ B. Heuninckx, "The EU Defence and Security Procurement Directive: Trick or Treat?" (2010) 19 *Public Procurement Law Review* 9.

⁹⁷ Although factual issues concerning suitability can be verified later.

actually precludes this prior to submission of tenders), which could involve unnecessary costs. Applying the current utilities rules to procurement covered by the Defence and Security Directive would both clarify the availability of an “open” approach as well as providing access to the advantages of the open procedure itself. This would again increase flexibility in the sense of enhancing the choices available to Member States (although allowing them, of course, the flexibility to use less rigid procedures than the open procedure should they choose to do so).

The procedures of the current Utilities Directive would also give sufficient flexibility for Member States to pursue value for money in the award of concession arrangements. There is, in the author’s view, no justification to make a distinction between concessions and other arrangements from a procurement perspective. The special treatment of concessions arose for purely historical reasons and many other complex contracts, notably privately financed infrastructure contracts, present exactly the same features as concession arrangements so far as procurement issues are concerned – for example, bids by consortia, long terms for the agreement, and uncertainty over the best technical, financial and legal solutions due to the complexity of the projects. A single directive based on the utilities rules that, in particular, allows free use of the negotiated procedure, would provide entirely suitable award procedures for all concessions, eliminating the need for any separate regulatory instrument on concessions.

As well as offering obvious flexibility for Member States in pursuing their objectives of value for money in the commercial aspects of procurement, as we have just discussed above, the utilities regime may also provides greater opportunities for promoting social and environmental objectives in procurement. However, the differences between the current Public Sector and Utilities Directives in this respect are rather unclear⁹⁸, and this is one area in which

⁹⁸ For a detailed analysis see Arrowsmith and Maund, note 90 above.

adjustment, or at least clarification, of the rules may be appropriate under any new directive. This issue is considered further in section 4.4.3 below.

Simplicity

In addition to providing greater *flexibility* for Member States, as discussed above, moving to a single directive based on the current Utilities Directive would at the same time introduce a very considerable degree of *simplification* of the current procurement regime, in the sense of making the rules easier to understand operate (both for procuring entities and for economic operators) and reducing uncertainty. Such simplification will reduce the costs of operating the rules and the costs of litigation, and allow procuring entities to devote energy and resources on obtaining value for money rather than to formal legal compliance.

Simplification will arise, first, from the fact that the rules of the Utilities Directive are less complex and detailed than those of the Public Sector Directive. For example, as we have noted above, there are no conditions that must be satisfied for using the different competitive award procedures (only for use of the negotiated procedure without a notice), and no closed list of evidence that can be demanded from economic operators. Further, the free availability of the negotiated procedure with a notice provides for the possibility of using an award procedure which, being very flexible, is also relatively simple, if Member States or (where permitted to choose the procedure) their procuring entities, prefer this. Thus the flexibility that appears to exist, for example, in holding discussions with suppliers after submission of offers, means that there is much less room for dispute over issues such as post-tender negotiations, or corrections to errors in tenders, than exists in other award procedures. It is notable that there have been very few proceedings in the Court of Justice concerning the procedural rules of the negotiated procedure with a competition under the Utilities

Directive, which may be because of the simplicity and clarity of the rules (although it is acknowledged there could also be other reasons to explain this).

Secondly, simplicity will be greatly enhanced if the above proposal is accepted by the very fact of having one single set of rules for different award procedures.

This will of itself make it easier to understand and operate the procurement rules. This is important particularly in the not uncommon case of procuring entities, economic operators, and advisors entities whose activities are subject to more than one of the three - and potentially, with the adoption of a new regime on concessions, four - procurement regimes.

In addition, simplicity will be further enhanced in this respect by removing some legal uncertainties and confusion over the relationship between the provisions governing the different regimes. The rules under the different regimes currently do not always fit together in a coherent and logical manner.

An example is the treatment of competitive dialogue. As mentioned above, in 2004 this award procedure was added to the Public Sector Directive as a procedure available (like the negotiated procedures) on limited grounds, for the award of particularly complex contracts. It was not included in the Utilities Directive: this was considered unnecessary since the negotiated procedure is a very flexible procedure capable of accommodating the type of procedure provided by competitive dialogue, as well as other procedural variations, and since it is freely available the Utilities Directive already provided Member States with the possibility for using the "competitive dialogue" approach. On the other hand, competitive dialogue *has* been made available under the Defence and Security Directive despite the fact that this directive, like the Utilities Directive, allows procuring entities free use of the negotiated procedure⁹⁹. However, competitive dialogue is not freely available

⁹⁹ Defence and Security Directive, Art.25.

under the Defence and Security Directive, but may be used only for particularly complex contracts, as under the Public Sector Directive.¹⁰⁰ The explanation given in recital 48 of the Defence and Security Directive for the inclusion of competitive dialogue is that use of either the negotiated procedure or the restricted procedure is not feasible in certain cases where competitive dialogue applies because it is not possible to define the contract with enough precision to allow candidates to draw up their offers. This is highly questionable in the case of the negotiated procedure since the negotiations allowed by that procedure can be used to that end, if necessary – including by following the same kind of approach as with competitive dialogue within the rules of a negotiated procedure – and inconsistent with the omission of competitive dialogue from the Utilities Directive¹⁰¹. Further, the reasoning in recital 48 of the Defence and Security Directive would, if correct, imply that certain complex contracts cannot be awarded at all under the Utilities Directive because of the absence of a feasible award procedure (restricted, open (by implication) and negotiated procedures all being categorised by the recital as unsuitable). This kind of confusion can be eliminated at a stroke by providing for a single set of procedural rules for all regulated procurement.

Another example of inconsistency and potential for confusion is found in the fact that the Defence and Security Directive contains many specific references to the possibility of taking confidentiality and security issues into account that are not found in the equivalent provisions of the Public Sector Directive or Utilities Directive¹⁰², even though confidentiality in contract performance (for example, in

¹⁰⁰ Defence and Security Directive, Art.27 and also Art. 1(21) defining particularly complex contract.

¹⁰¹ As well as with the approach sometimes adopted in practice to awarding contracts under the negotiated procedure: see section 2.2 below.

¹⁰² For a full account see Heuninckx, note 96 above.

handling of the data of medical patients) may also be relevant in the context of those directives. For example, Article 22 of the Defence and Security Directive states that the contracting authority is to specify in the contract documentation the measures and requirements necessary to ensure the security of classified contract information, and also states various contract conditions that the procuring entity may require tenderers and their subcontractors to meet to protect classified information¹⁰³. It is not clear why confidentiality and security concerns should not be permitted under the Public Sector Directive under its general provisions. The better view is that they are permitted to at least the same extent at all stages in the process¹⁰⁴ - but in that case it would be more logical for the directives all to be worded in the same way in these respects. In addition, the Defence and Security Directive includes certain clear *restrictions* on the way in which certain security-related matters should be dealt with, notably by defining what may be required with respect to proof of security of supply¹⁰⁵, that have no parallels in the other directives. Again, it is not clear why this matter should be dealt with expressly only in that Directive.

Another significant way in which a single directive could potentially enhance the simplicity of the procurement regime is by eliminating or reducing the complex rules that set the boundaries

¹⁰³ See also, for example, Article 45(2) of the Defence and Security Directive which in permitting exclusion for criminal convictions related to the economic operator's trade or profession refers expressly to infringement of existing legislation on the export of defence and/or security equipment, an explicit reference that is absent from the corresponding provision in Art.45(2)(c) of the Public Sector Directive.

¹⁰⁴ See also Heuninckx, note 96 above. In Case C-324/93, *The Queen v Secretary of State for Home Department, ex parte Evans Medical Ltd and Macfarlan Smith Ltd* () [1995] E.C.R. I-563, paras.44-45, indicated that ability to ensure security of the supplies delivered may be a contract award criterion, for example.

¹⁰⁵ Defence and Security Directive Article 43.

between them. This would be the case, in particular, if a single uniform regime were to be established for procurement covered by all three directives, including uniformity in the exclusions, the entities covered, the activities covered, and the thresholds for application of the directives. As regards the coverage of the Defence and Security Directive and the Public Sector Directive there is, it is submitted, very clearly no reason for a different approach to any of these matters, and the rules can be assimilated very easily. (The fact that some of the exemptions may never or rarely apply outside the field of defence and security procurement does not mean that it is necessary or desirable to confine them formally to that sphere only – if the substantive conditions for their use are met then they should be available regardless of the nature of the procurement). With regard to the Utilities Directive and the other two directives there is, again, no justification for the differences that currently apply between the three different directives as regards exclusions. However, in respect of other matters would need careful consideration, as there is room for debate over whether full uniformity of the coverage rules is feasible and desirable.

One first question here is whether the scope of procuring entities covered by the directives should be assimilated. In this respect, both the Public Sector Directive and Utilities Directive cover contracting authorities¹⁰⁶, but the Utilities Directive covers, in addition, “public undertakings” and entities (including private entities) that have special or exclusive rights to carry out one of the utility activities regulated by the directive¹⁰⁷. (The Defence and Security Directive applies to contracts covered by either directive that are concerned with the subject matter covered by the Defence and Security Directive). The relevance of the category “public undertakings”

¹⁰⁶ Public Sector Directive Article 1(9), Utilities Directive Article 2.

¹⁰⁷ Utilities Directive Article 2.

under the Utilities Directive has been reduced¹⁰⁸ by the fact that “contracting authority” has been interpreted broadly to include entities that supply goods or services to a market except where these operate on a wholly commercial basis¹⁰⁹ combined with the fact that entities that carry out utility activities on a commercial basis are largely exempt anyway from the directives¹¹⁰. The main difference between the directives thus lies in the fact that the Utilities Directive covers certain private entities that have special or exclusive rights. The case for regulating these entities at all is limited and they are not generally regulated under other trade agreements on procurement, including the World Trade Organization’s Government Procurement Agreement. An argument can thus be made that a new directive should simply limit regulation to bodies that are contracting authorities within the definition of the current directives. If that step were taken there would then (subject to the issue of thresholds discussed below) be no need for any definition of what are covered “utility” activities – contracting authorities would in principle be subject to a single set of rules for all their activities, whilst other entities would not be regulated.

Another difference between the coverage of the current directives that would need consideration, however, is the difference between the financial thresholds for their application. For supplies and services contracts these are much lower under the Public Sector Directive than under the Utilities Directive and the Defence and

¹⁰⁸ Although not necessarily eliminated, since it covers, for example, entities subject to a dominant influence of a contracting authority which might not be subject to the type of influence necessary (in terms of financing, management supervision or appointment) for the entity to be classified as a body governed by public law and hence as a contracting authority. However, it seems that this category is likely now to be at best insignificant and its inclusion in the directive of questionable value.

¹⁰⁹ On this see Arrowsmith (ed.), note 1 above, section 4.1.2.3.

¹¹⁰ See Arrowsmith, note 30 above, chapter 15.

Security Directive. Although some suggestions have been made for raising the thresholds under the Public Sector Directive in line with the other directives, this is probably impractical in the short to medium term given that the thresholds in the Public Sector Directive have been set in line with those of the WTO's Government Procurement Agreement, which guarantees access to certain procurements within the EU to some of the EU's trading partners, under reciprocal arrangements¹¹¹. The difficulty of any upward adjustment to these thresholds is increased by the agreement on revision to the GPA – including the reciprocal coverage of the Parties – which was concluded at the end of 2011¹¹². Harmonising the thresholds for the Public Sector Directive and the other directives would thus effectively mean reducing the thresholds for the other directives. Such a change would be a retrograde step from the perspective of flexibility. On the other hand, if the entity coverage of the Utilities Directive were changed so that only contracting authorities were covered, lowering the thresholds for utility activities would be quite a limited step. Assuming that that step is also taken, it is submitted that, on balance, the simplicity that would result from such a change – effectively precluding the need for any rules to

¹¹¹ See the works cited in note 18 above. Where utilities are covered by the GPA the higher thresholds of the Utilities Directive are reflected in that agreement. The higher thresholds for the Defence and Security Directive are based on the view that the GPA does not apply to such procurement (see recital 18 to that Directive). For the relevant GPA exclusions see GPA Article XXIII.1 and relevant exclusions in the EU's Annexes which exclude the procurement of Defence Ministries apart from purchase specified in a particular list, which does not include products of an exclusively military nature nor certain dual use products.

¹¹² On this see R. Anderson, "The conclusion of the renegotiation of the WTO Agreement on Government Procurement in December 2011: what it means for the Agreement and for the world economy", forthcoming (2012) 21 P.P.L.R.

demarcate the coverage of the “utilities” and “other” procurement rules in terms of defining utility activities and dealing with contracts for more than one activity – would probably justify lowering the thresholds for the relevant contracts. Applying a single, simple threshold for defence and security procurement might similarly be justified by concerns for simplicity. If, however, it is preferred to maintain a higher threshold for procurement of this kind, the most simple approach would be to define the scope of this lower threshold solely by reference to the scope of the relevant GPA exclusions.

In the author’s view the same thresholds should be applied also to concession contracts as to other types of regulated contracts.

4.4.3 Adjustments to the regime of the Utilities Directive

We have so far suggested that the way forward for reform is to apply a single set of rules to the procurement of contracting authorities based in principle on the rules of the current Utilities Directive. For the most part these rules provide a suitable regulatory framework as they stand at present. However, there are some aspects of these rules in which small changes or, at least, clarifications may be desirable as part of the reform process. The most significant are summarised briefly as follows.

First, and most significantly, the rules on framework agreements and dynamic purchasing systems need reconsideration. The rules on framework agreements in the utilities sector currently lack clarity and it is questionable whether they provide an adequate legal regime for controlling the use of frameworks by utilities¹¹³. This is particularly the case given that the placing of call-offs under framework agreements under the utilities rules appears to be wholly or largely excluded from the system of supplier remedies. This may be one area in which it is desirable to reduce rather than increase

¹¹³ See the discussion in Arrowsmith, note 30 above, pp.1062-1071.

flexibility, perhaps by applying a similar regime to that of the current Public Sector Directive. As regards the dynamic purchasing system concept, this has – as predicted by the present author when it was adopted¹¹⁴ – hardly been used¹¹⁵, and needs to be replaced by a truly dynamic system that allows procuring entities to purchase from electronic systems without the need for a new notice and call for tender for every call-off, based on offers that appear at the time of call-off on the electronic system.

Secondly, the rules currently provide that a notice of a qualification system can be used as the means to advertise a contract instead of a contract notice or periodic indicative notice only where the potential bidders are all to be drawn from the qualification system.¹¹⁶ There is no apparent justification for this: it simply results in less competition than might otherwise be available (although in practice a procuring entity can encourage non-registered providers that it would like to invite to register on the system before it commences the procedure). It would be useful to remove this restriction.

Thirdly, as the author has argued elsewhere, the rules on the conduct of electronic auctions in the Utilities Directive arguably need amending to allow negotiation of tenders after an auction procedure when the negotiated procedure is used: there is no reason why this possibility should be allowed in negotiated procedures in general, but not when an auction is held as part of the negotiated

¹¹⁴ Arrowsmith, note 30 above, p.1209.

¹¹⁵ See S. Arrowsmith, “Methods for purchasing on-going requirements: the system of framework agreements and dynamic purchasing systems under the EC Directives and UK procurement regulations”, ch.3 in S. Arrowsmith (ed), *Public Procurement Regulation in the 21st Century: Reform of the UNCITRAL Model Law on Procurement* (West, 2010/11).

¹¹⁶ Utilities Directive Article 54(9).

procedure¹¹⁷. The fact that this possibility is not allowed at present following an auction phase in negotiated procedures has resulted from the fact that text of the auction rules was drafted in the context of the Public Sector Directive and simply copied into the Utilities Directive without considering how the rules tie in with the other rules of the latter Directive. In practice, procuring entities will not generally wish to negotiate tenders after an auction, since auctions will generally prove more effective as tool for securing value for money without the possibility of negotiation. However, there are exceptional cases in which this may be useful, notably in the context of collaborative auctions, which research suggests are made more difficult if post-auction negotiations are prohibited¹¹⁸.

Another specific issue that needs some attention is the relationship between selection and award criteria. Specifically it is necessary to address the interpretation that has sometimes been put on the case of *Lianakis* that matters considered at selection stage can never be considered when applying the award criteria. It is not proposed to revisit this here this extensively debated issue¹¹⁹, other than to note the author's view¹²⁰ that any matter should be able to be considered at the award stage provided that is related to the quality of the offer, and that this can potentially include experience of tenderers' personnel *or* of the tenderer itself. Both may be of crucial

¹¹⁷ Arrowsmith, note 30 above, pp.1186-1188 and 1205-1206.

¹¹⁸ See S. Arrowsmith and A. Eyo, "Electronic Auctions in the EC Procurement Directives and a Perspective from UK Law and Practice", chapter 12 in S. Arrowsmith (ed), *Public Procurement Regulation in the 21st Century: Reform of the UNCITRAL Model Law on Procurement* (West, 2010/11).

¹¹⁹ See, in particular, Arrowsmith (ed.), note 1 above, at 6.7.2.6; P. Lee, "Implications of the *Lianakis* decision", 2010 (2) *Public Procurement Law Review* 47; S. Treumer, "The Distinction between Selection and Award Criteria in EC Public Procurement Law: A Rule without Exception?" (2009) 18 *Public Procurement Law Review* 103.

¹²⁰ Arrowsmith (ed.), note 1 above, at 6.7.2.6.

in assessing, in particular, the quality of professional services that is likely to be provided as compared with that of other tenderers. In the author's view, that this is possible is in fact the correct interpretation of the *current* directives and is not precluded by *Lianakis* and subsequent CJEU case law, which concerned cases in which the assessment was not on the facts directed at assessing the quality of the offer at all. However, because of the extent of confusion and the importance of the issue, some clarification along these lines is essential, either in the text or recitals of the new single directive, or in clear accompanying guidance.

Finally, there is some uncertainty over the possibility for promoting horizontal policies through procurement¹²¹, and clarification, and possibly reform, of these rules is needed. It is beyond the scope of this chapter to consider this issue in any detail, and we will not here consider the most controversial issues such as whether it is appropriate to remove the restrictions that currently exist on horizontal policies going beyond the way that the contract is performed¹²² (for example, requirements that a supplier's business as a whole should meet particular ethical or environmental standards, or limiting access to certain types of business, such as Small and Medium-sized Enterprises). However, there are three points that certainly need clarification to bring coherence into the current rules and remove uncertainty. One is the question of whether award criteria, contract conditions or other mechanisms for

¹²¹ On the rules in the utilities sector specifically see Arrowsmith and Maund, note 90, above. The points made here are relevant for all the current directives, however.

¹²² On the distinction between these and other policies see generally S. Arrowsmith, "Horizontal Policies in Public Procurement: a Taxonomy" (2010) 10 *Journal of Public Procurement* 149, and for an analysis of the distinction in EU procurement law S. Arrowsmith, "Application of the EC Treaty and Directives to Horizontal Policies: a Critical Review", ch.4 in Arrowsmith and Kunzlik (eds), note 17 above.

implementing horizontal policies can cover methods of production of supplies. There is some confusion on this point, since the European Commission suggests in its formal guidance that to do so is unlawful as a general principle¹²³. However, it also gives as examples of permitted criteria measures that appear to concern production, notably criteria relating to “green” energy and the possibility of using such measures is also supported by the case law¹²⁴. It needs clarifying that such measures are permitted in principle. Not least this is because to rule them out precludes any environmental policies that take account of the impacts of the whole life-cycle of a product and require procuring entities to focus on only some elements of environmental impact – an approach that is not only arbitrary but could be counter-productive when there are significant impacts at the production stage. Secondly, whilst contract conditions may clearly cover matters related to the workforce on the contract – for example, by requiring employment on the contract of long-term unemployed persons or those with disabilities - the Commission has suggested that it is not possible to use *award criteria* relating to these matters, except where tenders are otherwise equal¹²⁵. Again, it is suggested that this is incorrect in light of the case law of the CJEU¹²⁶ and it is also unjustified given that award criteria can

¹²³ European Commission, *Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement* COM(2001)566 final, p.10.

¹²⁴ For discussion see, in particular, P. Kunzlik, “The Procurement of “Green” Energy”, ch.9 in S. Arrowsmith and P. Kunzlik (eds), note 17 above.

¹²⁵ European Commission, *Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement* COM(2001)566 final, pp.14-15.

¹²⁶ Case C-225/98, *Commission v France* [2000] ECR I-7445 (*Nord Pas de Calais*), which the Commission in its Communication, above, interprets as allowing such considerations as award criteria only where other aspects of tenders

offer a more efficient method of policy implementation in some cases than contract conditions¹²⁷. There is need for clarification of the rules to this effect. Finally, it is widely considered that – at least under the Public Sector Directive¹²⁸ - economic operators cannot be excluded from a contract because of inability to perform contract conditions relating to workforce matters, on the basis that the former do not concern “technical” capability¹²⁹. This is unjustified since it places horizontal concerns on a lower level than commercial concerns without any good reason for doing so. Further, the distinction between different kinds of contract conditions for the purpose of determining technical capacity creates uncertainty since it is not clear into which category (technical or non-technical) some conditions, such as those relating to delivery and disposal of a product, fall. This matter also needs addressing.

are equal. However, this was not mentioned by the Court; nor is it easy to see how such a limit could be read into the directives.

¹²⁷ For a summary of costs and benefits of different approaches see Arrowsmith, note 122 above.

¹²⁸ On whether this is also applicable for the utilities rules see Arrowsmith and Maund, note 90 above.

¹²⁹ Based on Case 31/87, *Gebroeders Beentjes BV v Netherlands* (“Beentjes”) [1988] ECR 4635. For elaboration on this point see S. Arrowsmith, “Application of the EC Treaty and Directives to Horizontal Policies: a Critical Review”, ch.4 in Arrowsmith and Kunzlik (eds), note 17 above, at 8.1.4.

4.5 Conclusion

In this chapter we have, first, reviewed the different objectives of procurement regulation and have then, against this background, elaborated in detail the objectives of the EU's procurement directives and their relationship with the national procurement policies of Member States. We have demonstrated, in particular, that the directives do not aim at ensuring value for money for taxpayers but at achieving an open market in public procurement, and that value for money is in fact a matter for Member States' to address, within the constraints that the EU directives impose. This principle is of fundamental importance for developing the directives: this must be done taking into account Member States interests in ensuring value for money in accordance with their own circumstances, in accordance with the principle of proportionality. We have explained that these circumstances are different for different Member States which may, for example, have varying levels of corruption, differing markets, and diverse skill levels to take into consideration. We also explained that it cannot be assumed that transparency rules adopted to open up markets necessarily coincide with what is appropriate to achieve value for money in Member States and that such rules can in some cases conflict with Member State policies in this area.

The chapter has then outlined some proposals for reform. In this respect, it was suggested that the EU should regulate procurement through a single directive that sets out a single set of procedural constraints for all regulated procurement. This directive should take as its starting point the procedural rules currently found in the Utilities Directive although perhaps with some modifications, in particular as regards the rules on framework agreements, dynamic purchasing systems, and electronic auctions. Such an approach will afford the flexibility necessary for Member State to promote their own procurement policies, including value for money, in an appropriate way - in particular, it will allow Member States to authorise use of procedures involving negotiation, allow them to take account of the significant benefits of qualification systems, and

facilitate cost-effective approaches to advertising contracts. In addition, the approach advocated will greatly reduce the complexities and uncertainties that apply under the current regulatory regime. This will result both from the greater simplicity of the content of the utilities rules as compared with the rules that apply under the other directives, and from the very existence of a single regime, which, *inter alia*, will eliminate the need to operate under multiple regimes and to determine the boundaries between them. Thus this approach will promote both the flexibility and simplification objective of the current reform agenda whilst at the same, it is submitted, providing a suitable framework of rules for promoting the single market in public procurement in Europe.

5 Major challenges for Public Procurement – A Swedish perspective

*By Anders Wijkman**

5.1 Introduction

The Inquiry on Public Procurement was decided upon by the Swedish Government in September 2010. The purpose was to make a thorough review of current legislation, including the EU directives from 2004. The objective was to work in tandem with the already decided review at EU level, and to offer Swedish views and suggestions as regards the EU directives as early as possible in the process.

One major reason for the Inquiry was, no doubt, numerous complaints in recent years about the PP rules – and their implementation. The most prevalent critique concerns issues like:

- the provisions are not clear enough
- the provisions are too rigid and complicated to apply, not least for small actors
- the transaction costs are too high
- many authorities don't give PP the significance it requires
- competences are often lacking among those responsible for PP
- the rules prevent authorities and potential suppliers to negotiate, thereby making it difficult to achieve value for money,

* Chair Committee of Inquiry on Public Procurement; Senior advisor Stockholm Environment Institute.

- the ambiguities with regard to what environment criteria that can be applied,
- the increasing number of complaints in court lead to insecurity and barriers to optimizing procurement

The Inquiry – that I am leading – was given three main tasks:

- to make a judgement of the rule-based system by comparing the benefits with the transaction costs,
- to specifically make a judgement – and propose changes – with regard to the fulfillment of a number of societal objectives, like environment and social concerns as well as the inclusion of SME:s in the process,
- to propose measures so as to improve the information about PP in society. Current statistics and data collection leaves a lot to be desired in this area. In many respects we have very limited information, both with regard to the total volume of PP and, more specifically, its effectiveness.

The Inquiry is mandated to carry out its work in the most open and transparent way. Consequently we have organized a great number of hearings in different parts of Sweden, involving all major stakeholders.

The government directives form the backbone of our work. But general as they are, with regard to some of the more specific priorities in our work we have also been guided by the views expressed in the many hearings and meetings with stakeholders that we have organised.

5.2 Challenges

The Inquiry is in the midst of its work. We are in the preparations of a preliminary report to the government later this autumn. For many of the issues we are struggling with, it is simply too early in the process to make a final judgement or recommendation today. What I

can do, however, is providing you with some insights as to the major challenges we are dealing with:

1. Non-discrimination, equal treatment, transparency, proportionality and mutual recognition

At the core of our review, of course, is to both explore and help ensure that the fundamental principles of PP are being adhered to. Here I am referring to the principles of non-discrimination, equal treatment, transparency, proportionality and mutual recognition. In all our deliberations we are reminded of these principles and their importance.

2. Improve Statistics

As already indicated, our knowledge about PP is limited. We particularly lack data with regard to the extent that contracting authorities use "direct award of contracts". Direct awards, according to Swedish law, are only permitted for contracts of a considerably lower value than EU threshold values. There are indications, however, that direct awards quite often are being granted for contracts that go far beyond this level.

One obvious problem with regard to the poor quality of information in the field of PP is that many contracting authorities lack the means to follow up and evaluate their procurement activities. In fact, our studies so far confirm that less than a third of the public authorities in Sweden do proper follow-ups. This means that in the majority of cases the public sector does not really know whether it has received the goods and services it paid and asked for. This is a problem we are taking very seriously. We will propose a set of actions, aiming at improving the situation, i.e. data collection. The challenge is to do it in a manner that is cost-effective and not seen only as something benefitting the national level – and the government – but the contracting authorities, as well.

3. The purpose of the Public Procurement legislation

When exploring what the main objective of the legislation in this area should be, a clear message is emerging: "value for money". This is the response we do get both from the vast majority of contracting authorities and businesses in Sweden.

This is not surprising. The procurement of goods and services, after all, are undertaken to meet the needs and requirements of different forms of public services. Most citizens, no doubt, expect public procurement to be of high quality and under conditions that are economically advantageous.

On paper there could be a tension here, when comparing perceptions and expectations on PP in Sweden with the EU level and the EU directives. For the EU, the main purpose and objective of the PP directives is to promote cross-border trade. As a Task Force, we have no problem with using public funds in the best possible way, seeking out and taking advantage of competition in different markets to obtain a good deal – including the promotion of cross-border trade. But we see it more as a *means*, not an *end* in itself. We look forward to an interesting dialogue with our EU partners in the months ahead on this particular issue.

4. PP as a strategic resource

A general finding in our work so far is that many contracting authorities give far too low priority to PP. Those responsible for PP are rarely part of senior management of the respective authorities. Moreover, PP is often understaffed and competencies lacking. We are currently exploring a number of ways to change this. We do believe that turning PP into a strategic issue within the contracting authorities is a major prerequisite for achieving "value for money".

5. Increase the opportunities for negotiation and dialogue

In all our hearings there have been complaints about the fact that the opportunities for negotiation and dialogue are so limited in relation to Directive 2004/18.

When comparing with private business and with the rules guiding activities within sectors like energy, water and infrastructure the limitations are difficult to understand. When talking to business people in general, they stress the importance of building trust between the parties in a potential business transaction. If this is important in business in general, why not when the public sector is involved? It must be possible to increase the possibilities of dialogue and negotiation between the contracting authorities and potential contractors without endangering the principles of transparency, non-discrimination and equal treatment.

One strong argument in favour of increasing the opportunities for dialogue and negotiation is to pave the way for – and to facilitate – the emergence of innovative ideas and solutions. With current provisions – where negotiation is regarded as an exception – we know that many innovative ideas and solutions are never brought to the fore. So, the arguments in favour of more dialogue and negotiation are, in our opinion, very strong, indeed.

6. Greater focus on follow-up and evaluation

As already indicated, experience in Sweden tells us that contracting authorities in general devote far too little attention, both to the preparatory phases of PP and to follow-up and evaluation. Here we believe a lot can be done to stress the importance to view PP as a *continuum*. The follow-up is of particular importance – both with regard to the importance of “learning by experience” but, as well, to make sure that the requirements that were stipulated in the tender have been fully met by the supplier. Our Inquiry has been repeatedly informed by various economic operators that they did not bother to participate in a tender, because they did not feel they could live up to the requirements. Subsequently, the contract was awarded to a

competitor that, so they have told us, did not meet the requirements either – but without any consequences. Our conclusion is, that we have to do whatever possible to improve the situation so as to make follow-up and evaluation a priority for all contracting authorities.

7. The role of SME:s

One of the most frequent complaints with regard to the EU directives as well as Swedish Public Procurement legislation has been that they discriminate against SME:s. In fact, many stakeholders hold the view that the directives discriminate against all small actors, businesses as well as contracting authorities.

As already indicated, the statistical base is poor, meaning that a comprehensive analysis with regard to this particular issue is difficult to undertake. We do feel, however, that more can and should be done to encourage as well as facilitate the participation by SMEs. Some of the proposals put forward by our Inquiry, like increasing the opportunities for negotiation and dialogue, no doubt will improve the prospects of SMEs. In addition, several more specific suggestions are being considered, like splitting contracts in smaller parts, like raising the national threshold for direct awards and increasing procurement support for SMEs.

8. The evaluation of different award criteria

One of many critical issues raised during our work has been in relation to the provisions concerning the relative weighing of various contract award criteria. It has been pointed out, that the principles guiding the weighing can lead to results that are impossible to predict and often far from what was intended from the point of view of the contracting authority. Here we are exploring different alternatives, all with the aim of eliminating such weighing models that are irrelevant and risk leading to unwanted outcomes of the procurement processes.

9. Environmental concerns /Sustainability

In general, we consider that the existing directives provide relatively good opportunities to promote both environmental and social concerns. However, there are ambiguities within the existing rules that need to be clarified. We therefore suggest that the following changes in the EU directives should be considered:

- to make crystal clear that contracting authorities can go beyond minimum EU rules - as well as harmonized rules – when setting environment and/or social procurement criteria; there is a lot of uncertainty regarding these issues presently and clarity is of essence.

- to invite contracting authorities to call for comprehensive assessments of the environmental performance of products and services, preferably through lifecycle analysis, when deciding their procurement criteria; ambiguities exist today as to whether the environmental impact during both the production process of a product as well as transport emissions can be taken into account,

- to make it obligatory to take into account the life cycle costs when buying energy-related products,

Furthermore, given the seriousness of climate change, ecosystem decline and looming scarcity of some finite resources, like crude oil and rare earths, there is a need to explore further how PP could be used in a more strategic way with the aim of promoting sustainability. In order to move society in the direction of a sustainable, low-carbon development path, there is a need for more than incremental improvements in existing production and consumption systems – not least in the case of infrastructure investments, which are meant to last for many decades, if not centuries (such as buildings, energy-intensive manufacturing facilities and transport /communication infrastructure). Thus transformative solutions, allowing services to be provided in fundamentally new ways – meaning reductions in pollution and environmental impact in the range of 80 % or more – are urgently

needed. In our opinion, the public sector has an important role to play in this context.

For some types of infrastructure the public sector is the main actor. In other areas the public sector can very easily set an example and help move markets in the right direction. For this to happen, however, PP rules must be more flexible and, indeed, help encourage economic actors to develop innovative solutions. This means new forms for negotiation and dialogue between the contracting authorities and economic actors. The solutions aimed at will represent both technology leap-frogging and new ways of organisation.

One interesting alternative would be to base PP on buying services instead of products. One example would be the rental of electronic equipment as well as vehicles instead of purchase. Through such procedures, business models would change. Instead of earning revenue on endless new product models, companies would earn revenue on what is already produced and making efforts to extend wealth. Both energy and material flows would be significantly reduced.

10. Court reviews

A serious problem, not least recently, is the fact that an increasing number of PP decisions are being challenged in court. The total share of complaints last year was about 5 % of published tenders – and may not be looked upon as very high - but that represented a significant increase compared to previous years and this has resulted in quite serious consequences. One is, of course, the delay in finalising the respective PP contracts. Important public services risk being disrupted and existing rules make it difficult for public authorities to address a situation like this. This is the background for a suggestion made to the European Commission to introduce provisions that allow negotiated procedure without prior publication to procure those products and services that they are under a duty to

provide during a pending judicial review of the regular procurement.

Another serious consequence of the increase in the number of formal complaints is that the mere risk of a court review has led to a lot of anxiety among those responsible for PP. This means that many of those responsible "play safe", trying to avoid all possible risk, and thereby probably losing many interesting opportunities. A third problem is that for quite a number of complaints court decisions point in different directions, leaving both authorities and economic operators in somewhat of a void.

Within our work we are exploring various alternatives to try to minimise the negative consequences of court reviews. One option might be to follow the example of Denmark, where a special gvt agency has been established to handle complaints and provide a quick response. If those complaining are not satisfied with the outcome, the possibility to initiate a judicial process would still be there. But most complaints could be dealt with in a swift manner – a huge benefit to the system at large.

5.3 Conclusion

Ladies and gentlemen. These were some examples of the priority issues the Swedish Inquiry is working on. There are indeed a great number of other issues that merit concern. But I have been asked to give some high-lights from our work and hope I have been able to meet such demands. Many of the issues we have chosen to give priority to require a lot of discussion and consultations among stakeholders to arrive at the best possible outcome. I am very much looking forward to an intense debate in the months ahead.



KONKURRENSVERKET

Swedish Competition Authority

Address SE-103 85 Stockholm

Telephone +46 8 700 16 00

Telefax +46 8 24 55 43

E-mail konkurrensverket@kkv.se

www.konkurrensverket.se