

EFFICIENCY VERSUS ECONOMY IN PUBLIC PROCUREMENT

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Abstract

We argue that both active and passive corruption represent important problem in the Czech public procurement. We also propose that most of passive corruption is caused by “over-legislation” and the corresponding principle of bureaucratic safety. By documenting the problem of the too-frequent use of economy (lowest price) as the criterion for selecting the best bid by public procurers in CEE countries, we try to describe one concrete dimension of passive corruption. Usage of the lowest price criterion in public procurement has some advantages, but can deliver also problems if it is not used properly, as our two case studies proved. If the focus of procurement is on the process, on compliance with the rules rather than on the actual results, it is difficult to expect positive selections, especially for service and works. The only solution to this problem is radical change – to switch from a focus on the process to a focus on both the process and the results in public procurement by all the main actors, specifically the controlling and auditing bodies.

Key words:public procurement, lowest price, best bid

JEL Code:H11, H57

Introduction

During our research focusing on externalisation in the public sector (see, for example, Nemec, 2002, Meričková&Nemec& Vitek, 2005, Mikusova Merickova& Nemec, 2013), we discovered that the procurement process itself is the most important factor in determining the results of externalisation. Our research also indicated that there are several significant problems connected with procurement procedures for externalisation in the Czech Republic and Slovakia. First, although it is obligatory, many public organisations do not use competitive tendering to select the producer of the externalised services. Second, even if a public tender is organised, the number of effective bids is too small (in most cases) to represent genuine competition. Third, public organisations prefer to use economy (i.e., the lowest price) as the main criterion, rather than efficiency (best bid) to select the future

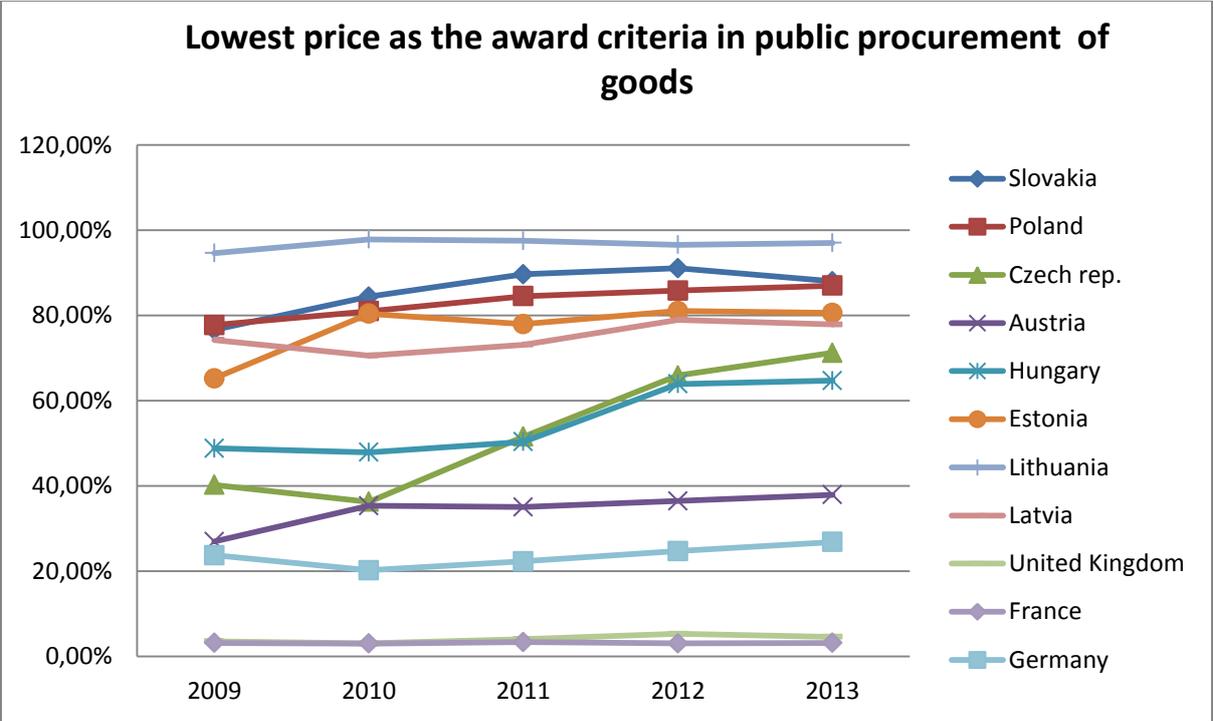
supplier. In our paper, we focus on the third issue from a more general perspective. This paper documents the problem of the too-frequent use of economy (lowest price) as the criterion for selecting the best bid by public procurers. The paper explains the reason for this situation. This kind of research is really rare and we believe that our results will be a valuable contribution to the existing knowledge.

1 Efficiency versus economy in public procurement

According to the existing literature (summarised, for example, by Ochran& Maaytova, 2012), economy should be used as the selection criterion only in cases in which the procurer can very clearly specify the ordered goods, services, or works. There are no generally valid estimates, but this guideline should mean that the lowest price is a main selection criterion for goods, but a less important selection criterion for services and works.

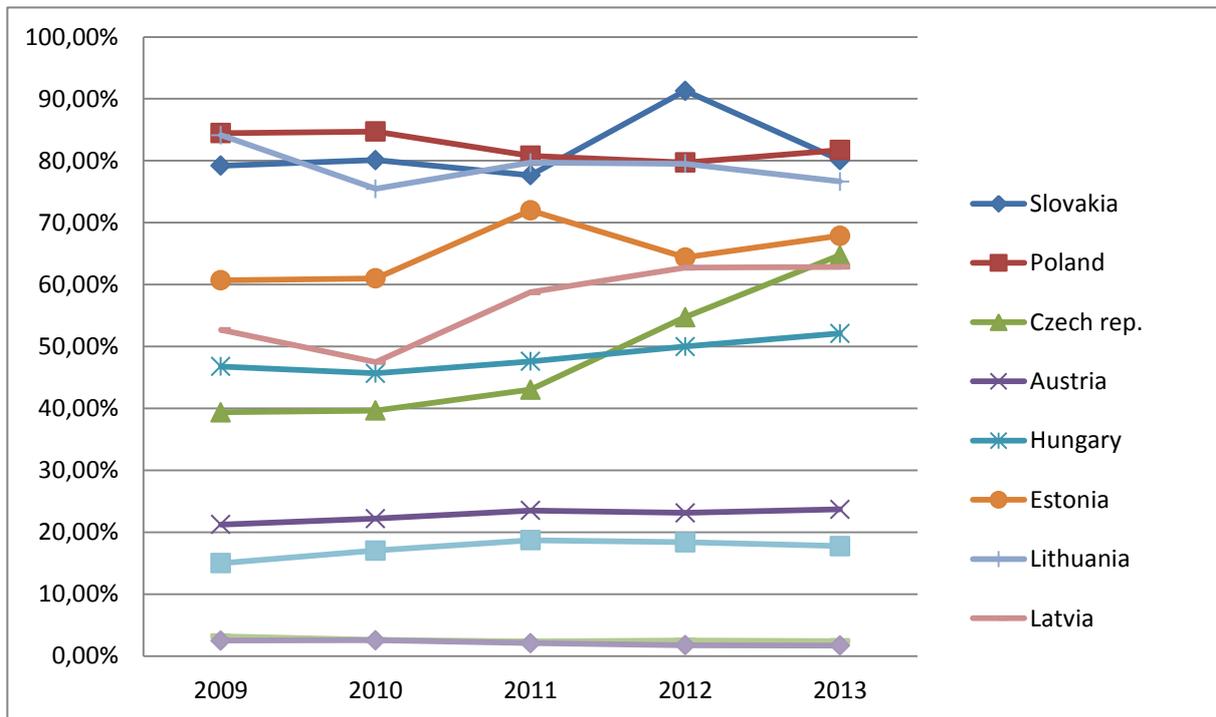
Our data about the frequent use of lowest price and best bid criteria in public procurement (non-weighted) are compiled from the international statistics for selected countries (Figures 1-3, EU Tenders Electronic Daily data processed). We included the most important CEE countries, the UK as example of Anglo-Saxon managerialism, France as example of a different (more bureaucratic) public administration system, and Austria and Germany as neighbours following the Weberian tradition.

Fig. 1: Lowest price as the award criteria in public procurement of goods



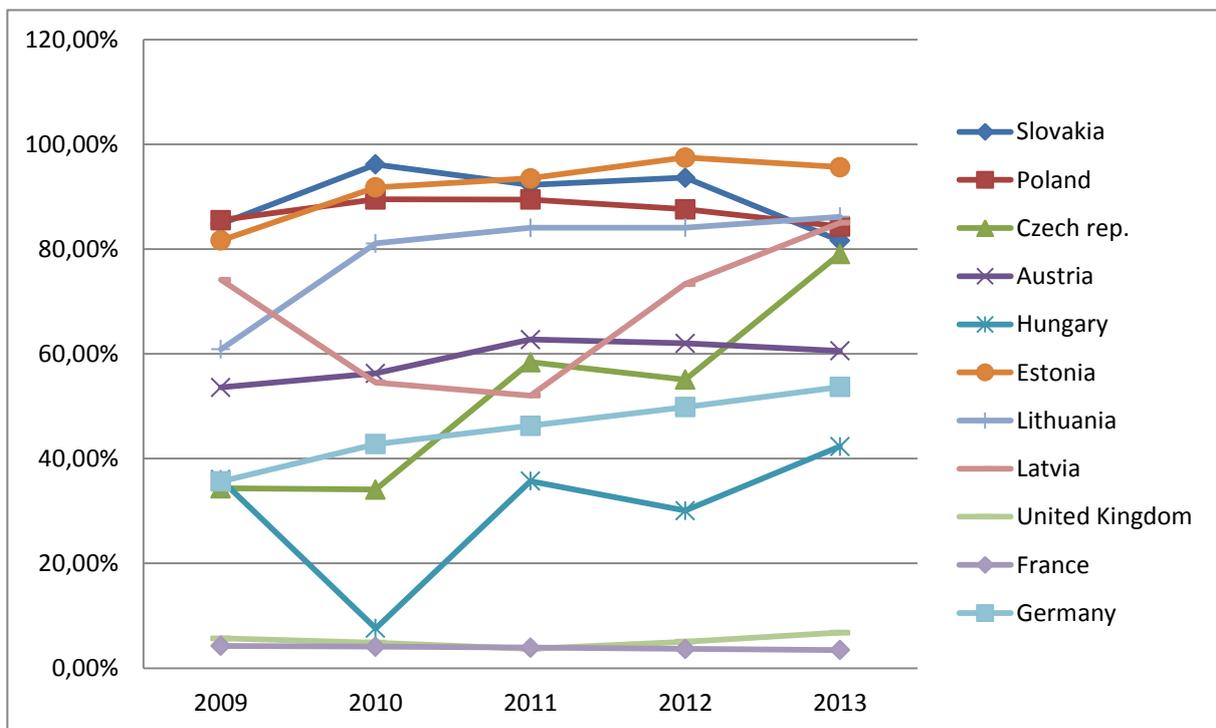
Source: own research based on data from Tenders Electronic Daily, 2014

Fig. 2: Lowest price as the award criterion in public procurement of services



Source: own research based on data from Tenders Electronic Daily, 2014

Fig. 3: Lowest price as the award criterion in public procurement of works



Source: own research based on data from Tenders Electronic Daily, 2014

The data above indicate that the number of economy-based procurement decisions in CEE regions is much higher than in any of the Western countries. The Czech Republic represents a particularly interesting case, with a significant recent trend towards the use of economy as a criterion. It is too complicated to say whether such trends are good or bad, but we may use existing data to document the most important aspects of the use of economy for selecting future suppliers of services and works. We present existing opinions, research data, and two case studies. One case study is a well-known Polish case, concerning works; the second is a smaller Czech case study from a service area.

1.1 Overview of existing information

We use two sources of information to document the problem of selection based on lowest price: OTIDEA research (information provided at a public meeting on October 3, 2013) and two case studies.

According to data collected by OTIDEA (2013 – responses of 152 suppliers and 450 procurement officials), eighty-five percent of procurers use lowest price as a criterion to select the winner because they are afraid of complaints by bidders. Seven percent of suppliers and six percent of procurers have the opinion that selection for works based on lowest price is not a problem. Sixteen percent of suppliers have offered prices below real costs. Twenty percent of procurers do not have experience with a situation in which an unrealistically low price won the contract; more than fifty percent of them had accepted such offers. Simplification of the PP law and higher managerial flexibility was desirable for seventy percent of procurers.

Case study 1: Polish highways (PPP)

In 2009 Poland decided to build almost 50 kilometres of the A2 highway (part of the highway between Warsaw and the German border) as a PPP (design and build) project. The selection criterion was lowest price.

The Chinese company Covec won both tenders. The final price was more than 72 percent cheaper than the estimated price, with the price for one km of highway slightly higher than 5 million euro (VAT excluded), which was the lowest price for a highway construction project in Central Europe at that time (according to the information from Tenders Electronic Daily – Table 1).

Tab. 1: Estimated and final price of 49.2 km of highway in Poland, VAT excluded

	Estimated price in PLN	Final price in PLN	Final price in EUR ¹
Tender 1 (announced in TED on October 3, 2009)	2,315,004,180	618,514,907	145,532,919
Tender 2 (announced in TED on October 7, 2009)	1,514,013,090	438,154,527	103,095,183
Sum	3,829,017,270	1,056,669,434	248,628,102

Source: Tenders Electronic Daily, www.ted.europa.eu, 2014

After the tender was announced, other construction companies took legal steps against Covec and accused them of price dumping. The public procurement office in Poland rejected the complaints and signed a contract with Covec. Serious problems started to be visible from the beginning of January 2011, when Covec did not pay the invoices of its subcontractors. In May 2011, Polish authorities sent an official letter to Covec requesting an explanation of significant delays of the construction works. In the beginning of June, two Chinese workers died and Polish safety authorities shifted their focus to the A2 construction work.

On June 13, 2011, less than two years after the contract was signed, Poland's road and highway construction authority cancelled the contract with Covec and started direct negotiations with other companies. Poland's road and highway construction authority quantified the total damage of not finishing the highway at 741 million Zloty (approximately 185 million euro in 2011) and had to pay 105.6 million Zloty (26.4 million euro) in direct payments to subcontractors to cover the costs of unpaid invoices to Covec (www.gddkia.gov.pl, 2014). The extra costs, and especially the delayed construction (highway not finished for EURO 2012 as promised), represent real problems for Polish authorities. Their selection based on a lower price did not deliver results, only problems.

Case study 2: Cleaning services

In 2012, the public organization XY initiated the procurement of cleaning services and connected services in its premises. The estimated costs were 35 million CZK. The decision

¹We used the exchange rate EUR/PLN = 4.25. This was the ECB average EUR/PLN exchange rate at the time when the contract was announced in TED.

was to use lowest price as the criterion for selecting the supplier and to assess its quality via qualification criteria. Unfortunately, only basic qualification criteria were used: positive economic results, minimum yearly turnover from delivering procured services for 20 million CZK, at least one contract over 5 million CZK and two contracts over 2 million CZK in the last three years, and quality certificates for ČSN EN ISO 9000 and ČSN EN ISO 14001. On the basis of the given conditions, a four-year contract was concluded with the selected supplier. Although all of the formal aspects of this tender were acceptable, the final result is really problematic. The management of this public organization receives complaints almost daily from employees concerning the quality of cleaning and connected services. The cost savings from selecting the lowest price are not real savings, because the quality of services delivered by the supplier is too low.

Probably the core problem is the small number of cleaning staff used for the delivery of this service. Unfortunately, the contract signed with the selected supplier does not include specifications of how the service should be delivered or real sanctions (thus, problems are caused both by selecting the service provider on the basis of the lowest price and by the poor quality of the contract).

The organization plans to re-tender the service (including some extra qualification criteria and an improved contract proposal), but it is still reluctant to switch from lowest price to best bid as the selection criterion. The reason for this reluctance is that unsuccessful bidders frequently (and many times successfully) oppose the use of selection criteria other than price (the public agency UHOS, which is responsible for regulating procurement, is of the opinion that only simple and quantitative factors can be used for selection, even in the service area).

The selection based on lowest price did not deliver results; moreover, the re-tendering means extra costs and extra risks (according to the current legislation, at least three bids are necessary in order to be able to select a supplier).

2 ‘Bureaucratic safety’ and ‘over-legislation’ – possible reasons for the high percentage of economy-based tenders in CEE countries

Many experts (Pavel, 2007, Pavel & Beblava, 2008, Sicakova Beblava & Beblavy, 2009, Dvorakova & Spacek, 2012) feel that ten to twenty percent savings in public procurement is a target that can be very simply achieved by improving the system. This in turn could make about three percent of the GDP available for more effective use. According to some experts (for example Nekola and Ochrana, 2009), the public procurement problems are connected

with both technical efficiency (getting value for money) and allocative efficiency (deciding what to purchase). In terms of technical efficiency, several authors (Pavel, 2013) mention the need to limit both active and passive corruption. Active corruption in public procurement can be understood as the intentional actions of procurers and suppliers to channel some part of public resources to themselves directly (Rose Ackerman, 1999). The existence of active corruption in public procurement is practically a normal feature of modern societies. The question is not whether such corruption occurs in public procurement, but the size and scale of it. The main objective cause of corruption in public procurement is the character and scale of the process. Public entities spend large sums to purchase goods and services or to construct public works. One problem is that the size and character of the public procurement market makes it very popular and enticing to all economic operators; private firms want to supply the government in these large contracts and might be willing to compete even unfairly for public orders. The second problem is that the private interests of the public servants involved in the procurement process may outweigh the principles of public needs and public services, especially in less-developed and insufficiently transparent public procurement systems. Many articles have addressed this type of corruption in public procurement, as well as its causes and possible solutions. However, very few articles have dealt with passive corruption, possibly because passive corruption is a less important problem in more developed countries. However, passive corruption may actually cost more than active corruption in CEE countries, and the reasons for this are connected with the specific character of the public sector and public administration in the CEE region.

Existing research indicates that administrative (and especially control and audit) systems in CEE countries prefer to focus more on the process (compliance with the rules, or “how we do things”) than on the results (“what was really achieved”), (see, for example, Nemeč, Ochrana, Šumpíková, 2008). This is clearly the case of public procurement in the Czech Republic, as directly documented by the OTIDEA data and by the second case report.

In conditions where compliance with the process is much more important than results, what is the preferred behaviour of the non-corrupt public officials responsible for procurement? We might expect that their focus is on ‘bureaucratic safety’ – the certainty that rules have been followed with the lowest risk possible, regardless of results. This phenomenon is exaggerated in situations in which the legislation is too rigid and too complex (“over-legislation”), as is clearly the case of public procurement in the Czech Republic and neighbouring countries. Pavel (2013) documented that the typical approach of CEE governments is to react to implementation problems with legislative and regulative changes

rather than with process changes. In this way, the complexity of procurement directives increases every year. With this, the risk of error increases and the space for managerial flexibility diminishes. Overly-detailed legislation and a compliance-focused approach by all of the main actors create a really difficult situation for procurement officials – any attempt at managerial flexibility is risky.

The typical response to such “over-legislation” is a preference for safe bureaucratic decisions. The process is the focus, rather than the results, resulting in significant monetary waste. It is not easy to document our assumption that the “over-legislation” of procurement exists and influences its results, but there are some options, as our paper indicates.

Selection based on the criterion of lowest price is safe; no such decision has been the subject of investigation by control and audit bodies in the Czech Republic. Selections based on the overall best bid may deliver better results, but purchases at a higher price to achieve better value can attract the negative attention of controllers or media.

To summarise, we argue that in the Czech Republic and similar countries, public resources in procurement are wasted by two core channels – active corruption (intentional behaviour) and passive corruption (unintentional waste of resources caused by the specific environment in the area). Treating both channels is a complex issue requiring major changes in societal values and subsequently in the procurement processes (Soukopova&Maly, 2013, Uramová&Pisar& Sipikal, 2010).

Conclusions

This paper demonstrates that non-efficient procurement is an important dimension restricting quality and a real problem in the Czech Republic and countries with similar conditions. We argue that passive corruption in public procurement is caused by “over-legislation” and the corresponding principle of bureaucratic safety. If the focus of procurement is on the process, on compliance with the rules rather than on the actual results, it is difficult to expect positive selections, especially for service and works. The only solution to this problem is radical change – to switch from a focus on the process to a focus on both the process and the results in public procurement by all the main actors, specifically the controlling and auditing bodies.

Acknowledgment

Our research was supported by the Czech Grant Agency GACR under contract No. P403/12/0366: ‘Identification and evaluation of region-specific factors determining outcomes

of reforms based on NPM - the case of CEE' and by the project No. VSE IP300040 financed by the University of Economics in Prague.

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