

SELECTED FACTORS DETERMINING THE PERFORMANCE OF THE CZECH PUBLIC PROCUREMENT SYSTEM

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Abstract

Public procurement represents today approximately 15 % of governmental expenditures in developed countries and represents the area with high potential for continual improvements, especially in countries in transition. This paper investigates three (from many) selected factors that for sure are purposes of the limited (see for example studies by Transparency International or the team from the Charles University) results of procurement procedures in our conditions: competitiveness, selection method and legislative gaps. Its findings show important weaknesses of the Czech public procurement process, which should be addressed by future reforms.

Key words: public finance, efficiency, effectiveness, competition, public procurement

JEL Code: H50, H57

Introduction

After 2008, most of the EU countries were trying to cut their public expenses to stabilize fiscal imbalances. We think that there is only limited space for decreasing the expenses and governments should rather focus on measures supporting efficiency and effectiveness improvements. One of urgent areas to change is the public procurement. Until now, most of the public procurement studies focus on usage of electronic auctions, transparency or corruption in public procurement, but there are only few articles, which are analysing competitiveness, selection method and legislative gaps. In our article, we are analysing these three topics, where the increase of efficiency by significant share is fully possible.

1 Factors influencing performance of public procurement system

Public procurement, especially in transitional and post-transitional countries can be the major area for efficiency improvements. Many experts feel (Pavel, 2013) that 10-20% savings in public procurement in our conditions are target that can be very simply achieved by

improving the system. This may mean that about 3% of GDP are available for more effective use!

The literature also describes and analyses possible purposes for such a large inefficiency of the public procurement process in our conditions. The cross-cutting issue is the corruption. According to existing data, the general level of corruption in transitional and post-transitional countries is really high (see for example Transparency International data) and unavoidably influences also public procurement and its results. The response by increased transparency does not help much, just motivates for more sophisticated ways of channelling public resources via procurement (see recent scandals).

Bušina, (2013a) mentions in connection with public procurement the need to adhere not only to so called transparency but also to moral and ethical principles. Bureaucracy, confusing legislative system, often legislation amendments and change of requirements of the government significantly destabilize, make conditions more severe and make the law enforceability more complex. He mentions following concrete issues - high level of fluctuation at key positions (ministers, vice-ministers, department managers, state owned company managers etc.), instalment of laymen to positions that require professional qualification (instead of employing eligible people from the point of view qualification and security at such positions), low capability to understand the line of business and resulting problems in the field of the withdrawal of EU subsidies.

Not only “active corruption” is well described by existing literature (Rose Ackerman, 1999), but more and more authors analyse also “passive corruption”. This concept is relatively new but already investigated also in our conditions (Pavel, 2013). “Passive corruption” means wasting public money for nobody’s interest, without direct corruption. In the later analysis we deal with two from its many dimensions. First is the issue of the “bureaucratic safety” and its impact on award criteria. The second is the existence of legislative gaps with definite negative impact on the realisation processes.

A lot of literature focuses on competitiveness. Authors, like Kuhlman and Johnson, 1983, Brannan, 1987, Gupta, 2002, Ilke et al, 2012 or Pavel, 2009 in our conditions, propose that competitiveness is one of major factors influencing results from public procurement. It is hardly possible to achieve efficiency and/or quality gains, if too few potential suppliers compete for a government contract. Gupta (2002) for example calculated that the increase in the number of candidates from two to eight implied achieving additional savings in average 12 to 14% (in analysis of data adjusted by extreme values, where the full competitiveness

status was reached with 6 candidates, the increase in number of candidates from 2 to 6 meant additional savings in average 9 to 10%).

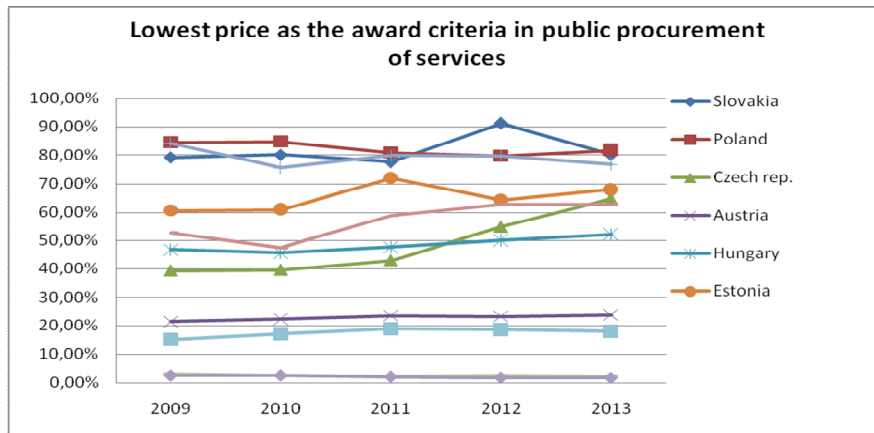
Passive corruption and competitiveness are two core issues of our paper. However, we add third one, rather specific for our conditions – the existence of legislative gaps and the restrictive interpretation of the PP law. Unfortunately, legislators react to main PP scandals via amending the PP law and creating it more and more restrictive. We document that such approach can lead to large inefficiencies – value for money, which is the core PP principle, cannot be achieved by bureaucracy, but by managerial flexibility.

2 Price as the main selection criterion

Our assumption is that too much bureaucracy in procurement motivates non-corrupted public officials (because of “safety” principle) to use economy (lowest price) as the selection criterion compared to efficiency (best bid). According to the existing literature (summarised for example by Pavel, 2013) economy shall be used only in cases where the procurer can really well specify ordered goods, services or works. There are no generally valid estimates, but this should mean that a lowest price is the main selection criterion for goods, but less important selection criterion for services and works.

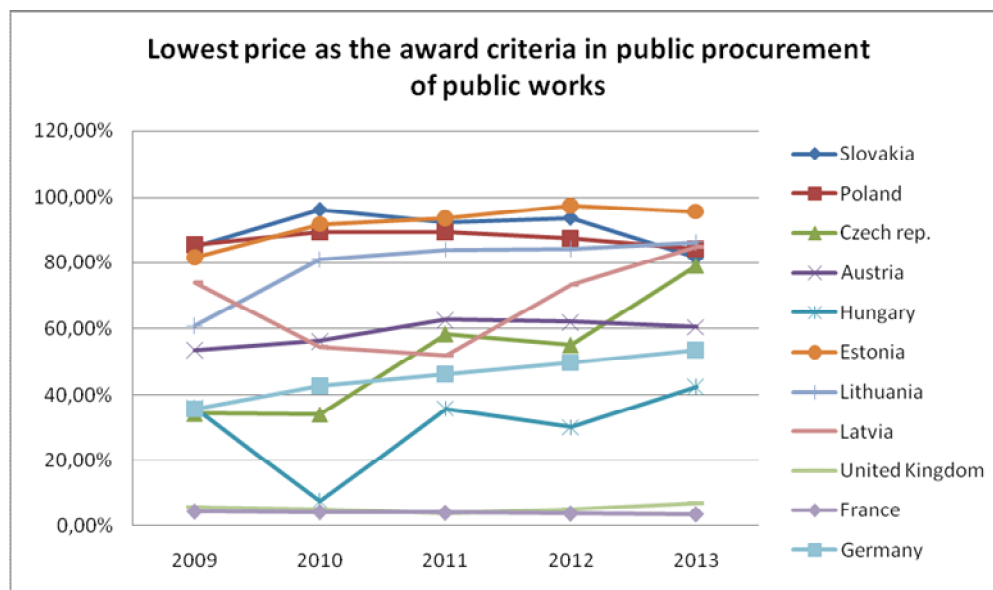
Our data compiled from the international statistics for selected countries (most important CEE countries, UK as example of Anglo- Saxon managerialism, France as example of different public administration system and Austria and Germany as neighbours with Weberian tradition) are displayed by Figures 1-2 (EU PP statistics data processed). These data clearly show that the main principle for selecting suppliers in CEE conditions – also for services and works, where this is not appropriate - is the lowest price criterion.

Fig. 1: Lowest price criterion in public procurement of services



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

Fig. 2: Lowest price criterion in public procurement of works



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

An example of a public procurement contract chosen by the lowest price criterion, we can now point out in the Czech Republic is the key transport artery as currently under construction, namely the motorway D1. We can already see in this case that the choice of the lowest price criterion was not the best solution and influences the implementation of the project: completion date is being postponed; it generates problems between the contractor and contracting party; litigations are under way concerning use of improper materials in order to reduce input costs on the part of the contractor; litigations are under way as to alleged poor quality of tendering documentation the contractor used for the preparation of the price quotation; endeavour to get maximum profit by means of increasing prices (of extra works).

Tab. 1: D1 Motorway Reconstruction Public Contract

Section name	Anticipated price €uro mio	Winning price approx. €uro mio	"Savings"	The winner with the lowest quotation
Section 05: EXIT 41 Šternov – EXIT 49 Psáře	30,484	18,481	60,6 %	Dálniční stavby Praha a.s.
Section 09: EXIT 66 Lohet – EXIT 75 Hořice	36,933	20,296	55,0 %	Dálniční stavby Praha a.s.
Section 14: EXIT 104 Větrný Jeníkov – EXIT 112 Jihlava	34,873	24,037	68,9 %	Sdružení CPI pro D1 (COLAS CZ a.s., PORR a.s.)
Section 21: EXIT 153 Lhotka –	35,823	22,074	61,7 %	Sdružení D1 Lhotka – Velká Bíteš

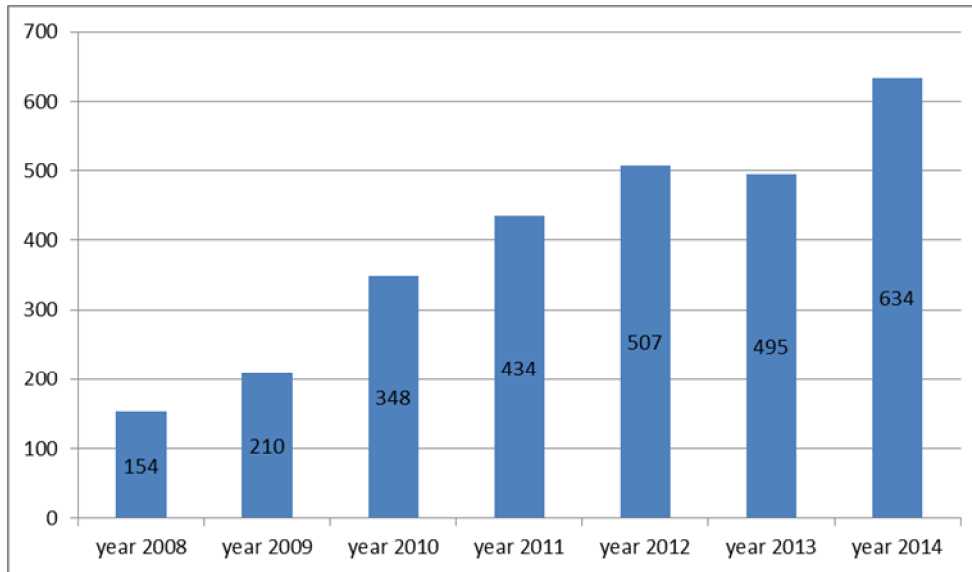
EXIT 162 Velká Bíteš				(OHL ŽS a.s., ALPINE Bau CZ s.r.o.)
Section 22: EXIT 162 Velká Bíteš – EXIT 168 Devět křížů	23,601	14,148	59,9 %	Sdružení D1 Velká Bíteš – Devět křížů (OHL ŽS a.s., ALPINE Bau CZ)
Total €uro mio / average %	161,715	99 074	61,3 %	

Source: Bušina, 2013b

Reasons that lead individual building companies to quote dumping prices may be as follows (Bušina, 2014) – awarding the contract in order to resolve company’s own economic problems using newly obtained financial resources; awarding the contract in order to keep the current turnover because of dependency on bank guarantees or current accounts; undermining of the public tender in order to be able to blackmail other candidates to force them to come with a financial proposal or sub-contract; awarding the contract at dumping price planning to misuse mistakes in the tender documentation to require extra works; awarding the contract at dumping price being aware of mistakes in the tender documentation and planning to start a litigation.

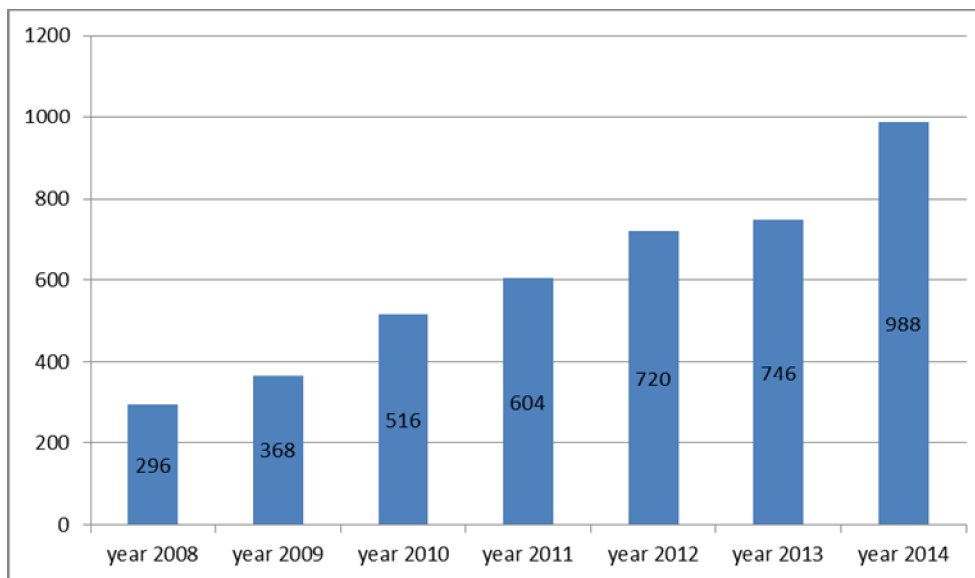
The same important is to mention the fact that another noticeable phenomenon has been emerging since quite some time simultaneously with dumping prices that are highly current at the time being based on the lowest price criterion in public procurement tenders. Such phenomenon that threatens the economy of the country is the misuse of administration procedures run by the antimonopoly authority based on proposals and filings to the authority. If we look at the figure 3-4, we can see that this filing trend shows a permanently growing tendency. This growing tendency may be attributed to unfair practices of individual candidates that accompany the public procurement and directly affect the behaviour of the human factor in public tenders as competitors get inconvenienced due to unsubstantiated interventions in individual contracts. (Bušina, 2014)

Fig. 3: Number of received petitions



Source: Bušina, 2014

Fig. 4: Number of received inducements



Source: Bušina, 2014

Comparing individual proposals to start administration procedures starting from 2008 to 2014, we can conclude that many of the entities whose “filings” protract the tendering process withdraw their filings without being held responsible in any way. This fact is even more supported by the fact that the antimonopoly authority does not require any security.

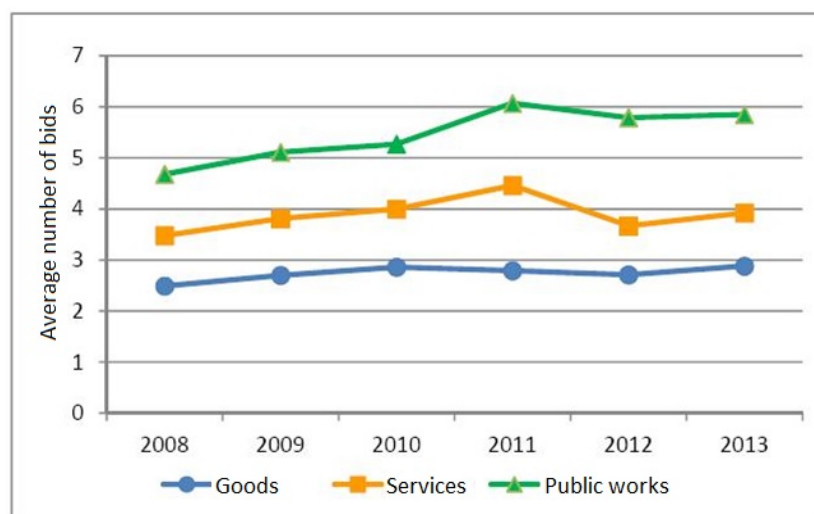
We argue, that bureaucratic decisions of the regulatory body (UHOS) in the recent years simply push procurers to opt for safe, but frequently ineffective decisions. We do not

have data for CIS countries, but for example in Georgia, lowest price is the only available selection criterion, for Russia the situation is almost the same (Ivanov, 2014).

3 Competitiveness

This issue is already investigated in the Czech literature. Pavel (2013) analysed the influence of competitiveness in the price for construction of road and railway infrastructure in Czech Republic from 2004 to 2009. In his work he used the relation of the estimated contract value and the winning price, wherein he found that in average every other candidate decreased the final price by 3.275 % *ceteris paribus*. An important finding is pointing the fact that with increasing number of offers the winning price decreases, but the share of five biggest construction companies on the total volume of contracts does not decrease. The author refers to the fact that stronger competitive environment forces five strongest companies on the market to lower the prices to keep their market share and win the contract. In this paper we present our data calculated from information which is every year published by Czech Ministry of Regional Development (Figure 5).

Fig. 5: Competitiveness in the Czech public procurement from 2008 until 2013



Source: Public procurement annual report for 2013, Ministerstvo pro místní rozvoj ČR, 2014

Compared to international practice, such level of competitiveness is rather limited (especially for goods) and limits the chance for better economy and efficiency.

4 Selected (Czech) legislative gaps and their impact on procurement implementation

In this part we very briefly highlight two selected legislative gaps (and legislation interpretations), parts of the Czech public procurement law, which significantly and in negative way influence the efficiency of the public procurement process.

The first issue is the “aggregation rule” – procurers shall cumulate values of goods or service supplies for the whole accounting year (for example paper supplies during the year cannot be realized as independent supplies, but represent one cumulative supply) and especially “cannot split the procured item with the intention to procure with simpler methods” (§13, part. 3). The authors of the law argue that both requirements are derived from EU directives, but this is not true (in most PP laws in EU the issue connected with the §13, part. 3 is formulated differently and in much more flexible way. The authors also argue that with cumulating economies of scale can be achieved. The reality is different in many cases – aggregation can for example limit number of tenderers, provides space of collusion cartel approaches and increases transaction costs. The most important problem is limiting the flexibility at the procurers’ side. In many cases single source procurement for small items is much more effective compared to complicated large volume purchases, especially if the chance to use framework contracts is rather limited in the Czech environment. According to our opinion “value for money” and not administrative aggregation should be the core leading principle for assessment of aggregation or disaggregation of purchases. Moreover, aggregations limit the chance of small and medium size enterprises to participate in procurement. The last but not least issue is the problem of large organizations consisting of many organizational units without legal status – cumulating (for example on the university level) all supplies is rather complicated and might be ineffective for units outside of the main seat.

The second critical issue is “extra works”. According to the international knowledge, public works almost in all cases require additional works or certain amendments, because of mistakes in the project, non-expected circumstances or other force-majeure cases. Such cases are handled by the EU directives that allow direct purchase of extra works up to 50 % of original price in rather nonrestrictive way. The Czech legislation is much stricter – wording of the respective paragraphs is more restrictive and the limit is 20 %. The Czech law especially says that this method can be used only in the case of “objective non-predictable circumstances”. Such wording is unclear and together with the explanation practice by the ÚOHS creates important problems. The decision ÚOHS-S154/2010/VZ-11410/2010/530/Edo from 10. 12. 2010 is clear example. The procurer was fined for extra works procured directly

from originally selected works supplier, caused by mistakes in the project documentation (project was prepared by outsourced agency). For example, how can be small organisations, like municipalities with 500 inhabitants, small health establishments and many others be responsible for the quality of projects for works under their responsibility??? Also this case indicates that the Czech legal PP system is mainly about compliance and not about value for money. The extra works should be procured in most cases from the originally selected supplier, and the issue is proper contract amendment, transparently showing why and for how much, and not restrictive legal and interpretation approach, working against the value for money.

Conclusion

Our paper argues that the best way how to balance the public revenues and expenditures today are efficiency improvements and provides important example of one area with large improvement potential – public procurement. According to our estimates up to 5% (or may be even more with more pessimistic approach) of GDP is wasted because of allocative and technical inefficiencies in our public sector, from it may be 3 % via ineffective public procurement.

From many factors determining the success of public procurement we investigated in the Czech conditions three – “passive corruption” from the point of view of improper use of price as selection criterion, competitiveness and selected legislative gaps with the negative impact on procurement process. Data and examples provided clearly show that there is a lot of space for improvements and all three factors discussed need much more professional and especially political attention.

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ÚOHS decisions, available at: www.uohs.cz/download/VZ_verejnost

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