

# Lecture 9: Public procurement

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# Course schedule

▶ Syllabus

Week	Date	Topic	Chapters	Lecturer
1	Feb 18	Economic rationale for the government	1, 2, 3, 4, 5	Miroslav Palanský
2	Feb 25	Public budgets	10, 26, 27	Natalia Li
3	Mar 3	Inequality		Marek Šedivý
4	Mar 10	Old-age pensions		Ondřej Schneider
5	Mar 17	Health economics	12	Ondřej Schneider
6	Mar 24	Public choice theory	7, 8	Miroslav Palanský
7	Mar 31	Cost-benefit analysis	6, 10, 11	Petr Janský
8	Apr 7	Externalities	9	Miroslav Palanský
9	Apr 14	Public procurement		Miroslav Palanský
10	Apr 21	Taxation, tax incidence	17, 18	Miroslav Palanský
11	Apr 28	Optimal taxation, personal income taxation	19, 20, 22	Miroslav Palanský
12	May 5	Tax evasion	23, 24	Petr Janský
13	May 12	Corporate taxation	21, 25	Petr Janský

## Course requirements

► Syllabus

Requirement	Maximum points	Announced	Deadline
Problem Set 1	10	Mar 24	Mar 31, 23:59
Problem Set 2	10	Apr 14	Apr 21, 23:59
Wiki Edits	20	Feb 18	Apr 28, 23:59
Final Exam	60	Exam 1 on May 19, 14:00 Exams 2, 3 in June Exam 4 in September	
Total	100		

# Today's lecture

Publicly provided goods

Public procurement in practice

Research on PP

## Summary of our progress in the course

1. When does/should the gov't intervene in the economy?  
→ Market failures
2. **How does/should the gov't spend money?**  
→ **Expenditure programs**
3. How does/should the gov't raise money?  
→ Taxation

## Publicly provided goods

- ▶ “Publicly provided” means **paid for** by the public sector (i.e. financed using government revenue)
- ▶ Publicly provided goods can be **supplied** in two ways:
  - ▶ by the public sector: government agencies, employees
  - ▶ by the private sector: public procurement
- ▶ Public procurement: how to choose the supplier in order to maximize social welfare gain (consumer surplus)?
- ▶ Main issues:
  1. Principal-agent problem (corruption)
  2. Finding the cheapest/best supplier

## Principal-agent problem

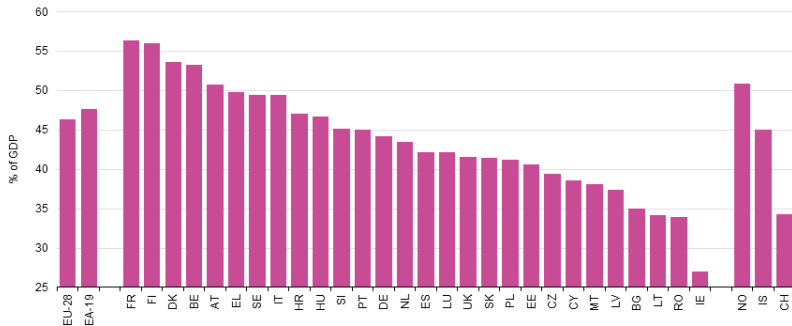
- ▶ Occurs when one person or entity (the “agent”) makes decisions on behalf of another person or entity (the “principal”), but the agent’s own interests are not the same as those of its principal
- ▶ Our context: politicians are agents and maximize their own private welfare, voters are the principal and maximize social welfare
- ▶ Solution: aligning private interests with the public interests
- ▶ Our context: strict procurement regulation (→ inefficiencies), transparency

## Choosing the cheapest/best supplier

- ▶ Private firms compete to supply publicly provided goods
- ▶ Perfect competition would lead to the maximization of social welfare
- ▶ Limited competition (recall market failures) may lead to high private gains
  - ▶ Monopoly, oligopoly, cartels, ...
  - ▶ Imperfect information
- ▶ Solution: auctions, market research (automation), transparency

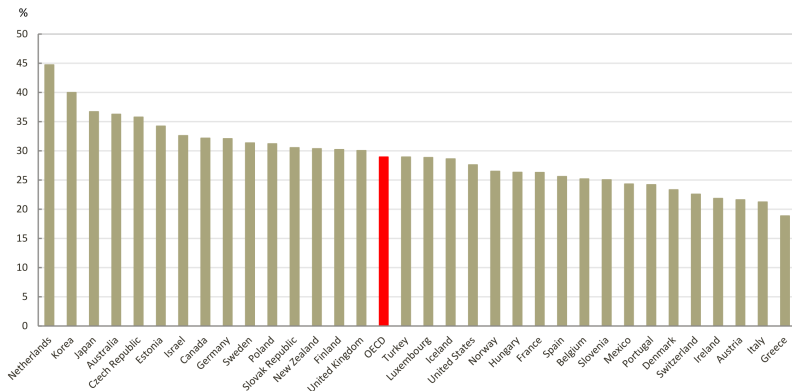


# Government expenditures (% of GDP)



Source: Eurostat

# Public procurement (% of gov't expenditures)



Source: OECD

## Scope of PP

- ▶ Every developed country: 5 to 15% of GDP
- ▶ Who is subject to it?
  - ▶ State, regional governments, municipalities
  - ▶ Their enterprises
  - ▶ EU funds recipients
- ▶ Heavily regulated (in most countries), EU – partially harmonized
- ▶ Rules:
  - ▶ 0-2 mil. CZK = local rules (if any)
  - ▶ 2+ mil. CZK = national rules
  - ▶ 10+ mil. CZK = EU rules

## Public procurement: Steps

1. What to buy: Subject specification
2. How to choose supplier: Procedure type
3. Who can apply: Qualification criteria
4. Who is chosen: Selection criteria

# 1. Subject specification

- ▶ School? Bridge? IT system?
- ▶ How much of good X, how much of good Y?
- ▶ Policymaker's opinion = proxy for public interest (recall representative democracy)
  - ▶ Different preferences of voters (tastes, income, tax), but translated into politics
- ▶ As concrete as possible (to better choose the supplier), but not too concrete (to better choose the supplier)

## 2. Procedure type

- ▶ Open
- ▶ Restricted
- ▶ Negotiated with publication
- ▶ Negotiated without publication
- ▶ Innovation contest, competitive dialogue
- ▶ Optimal choice depends on the market shape and the ability of buyer to specify upfront what he wants

## Open procedure: types of auctions

Two main ways to classify auctions:

1. Bidding process: sealed bid vs. open bid
2. Price determination: first price vs. second price

	<b>Open bid</b>	<b>Sealed bid</b>
<b>First price</b>	Dutch (descending price)	FPSB
<b>Second price</b>	English (ascending price)	Vickrey (SPSB)

### 3. Qualification criteria

- ▶ Goal: Assure that bidder is capable to deliver (elimination of “garage” suppliers)
- ▶ Minimum turnover, expert employees..
- ▶ BUT – too restrictive criteria = limiting competition
- ▶ Typical means of corruption



## 4. Selection criteria

- ▶ Lowest price vs. Multicriterial (MEAT)
- ▶ In 80% of tenders, lowest price used (in Eastern Europe)
- ▶ Is it a good idea?
- ▶ But what else? Quality—how?
  - ▶ Criteria need to be explicit and auditable

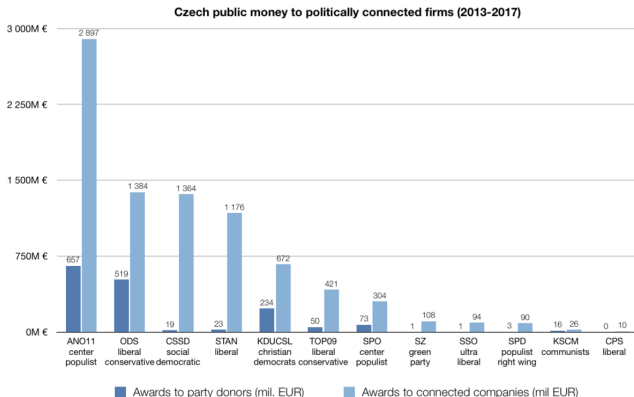
## PP data

- ▶ Data generally of terrible quality → little research, little evidence-based policy
- ▶ Opentender.eu, national sources, USAspending.gov
- ▶ CZ: exceptional data, Econlab/Datlab, zIndex.cz

## PP and conflicts of interest

- ▶ Throughout the PP process, there are opportunities for political corruption
  - ▶ Qualification criteria in favor of specific firm
  - ▶ Direct award to specific firm / closed procedure type
  - ▶ Award process manipulation
  - ▶ Secrecy (non-transparency): ownership, tax abuse

# 15% of Czech tenders awarded to connected firms



Source: Datlab (2017)

## Existing research

- ▶ Titl and Geys (2019)
  - ▶ Public procurement is more likely to be supplied by firms that donate money to political parties
- ▶ Palguta and Pertold (2017)
  - ▶ Tenders accumulate below regulatory thresholds
  - ▶ These tenders more likely supplied by anonymous firms
- ▶ Janský et al. (2020)
  - ▶ Tenders are disproportionately often supplied by firms linked to tax havens
  - ▶ Firms linked to tax havens more likely to supply less-regulated tenders

**Thank you!**

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## References I



Janský, P., Palanský, M., and Skuhrovec, J. (2020). “European Public Procurement and Tax Havens”. *Under construction* (cited on p. 21).



Palguta, J. and Pertold, F. (2017). “Manipulation of Procurement Contracts: Evidence from the Introduction of Discretionary Thresholds”. *American Economic Journal: Economic Policy*, 9(2) (cited on p. 21).



Titl, V. and Geys, B. (Jan. 2019). “Political Donations and the Allocation of Public Procurement Contracts”. *European Economic Review*, 111 (cited on p. 21).