MORE COMPETITION-ORIENTED PUBLIC PROCUREMENT TO FOSTER SOCIAL WELFARE

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ABSTRACT: Competition is the best means to ensure efficient allocation of resources. Hence, the achievement of value for money depends crucially on the development of public procurement activities in highly competitive markets. However, public procurement can generate significant (negative) effects on market competition dynamics—which, in a significant number of instances, result in a loss of efficiency and, ultimately, of social welfare. Therefore, competition-restrictive public procurement is self-defeating. However, most publicly-generated competition restrictions are avoidable—particularly through the establishment and full-enforcement of a competition principle.

Based on the regulatory situation in the European Union, this paper focuses on the relevance of placing a competition principle amongst the basic foundations and goals of public procurement (together with transparency and efficiency), and offers general criteria for the development of a competition-oriented public procurement system that furthers social welfare by means of increased value for money.

INTRODUCTION

Competition has always been an essential element in the construction of public procurement systems and, together with non-discrimination and transparency, ranks (or should rank) amongst the top goals of every procurement system (Kelman, 1990; Arrowsmith *et al*, 2000; Schooner, 2001 & 2002; Trepte, 2004; Weiss & Kalogeras, 2005; Perlman, 2007; Schooner *et al*, 2008; Schiavo-Campo & Mcferson, 2008; Dekel, 2008). The relevance of exploring and reflecting on competition issues in the framework of public procurement derives

not only from the general premise that the regulation of economic activities should be shaped and constrained by economic principles and that its rules should be consistent with economic theory (Stigler, 1972 & 1975; Posner, 2007)—but also from the strong (and, more than probably, increasing) reliance of the public purchaser on the market in order to discharge a significant number of activities in the public interest (Kettl, 1993; Light, 2004; Vincent-Jones, 2006).

The effectiveness of public procurement and its ability to contribute to the proper and most efficient carrying on of public interest obligations is conditional upon the existence of competition in two respects or separate dimensions. One of them has been expressly recognized for a long time by public procurement regulations, which have tried to foster *competition within the specific tender* or procurement process to the largest possible extent. Public procurement rules protect and promote competition—in this narrow sense—as a *means to achieve value for money* and to ensure the legitimacy of purchasing decisions (*ie* to prevent corruption and favoritism). From this perspective, competition is seen as a key instrument to deter favoritism and other corrupt practices and deviations of power (Schooner, 1999; Dekel, 2008), as well as a means to allow the public purchaser to obtain the benefits resulting from competitive pressure among (participating) bidders (Yuspeh, 1976; McAfee & McMillan, 1987)—since increased competition in public procurement generally yields better economic outcomes and improves the conditions in which the public buyer sources goods and services in the market (Demsetz, 1968; Miller, 1976).

However, a subtler and stronger dependence of public procurement on *competition in the market* exists—but it is implicit and has generally been overlooked by most public procurement studies (exceptionally, it has been stressed by Trepte, 2004). Indeed, in order to attain value for money and to work as a proper tool for the public sector, public procurement activities need to take place in (thriving), competitive markets (Kettl, 1993; Cox, 1993; Schooner, 1999; Cooper, 2003; Brunk, 2006; and Anderson & Kovacic, 2009). Public procurement rules assume that markets are generally competitive—in the broad sense—or, more simply, take as a given their economic structure and competitive dynamics (Thai, 2001; Piga & Thai, 2006). The existence of competitive intensity in the market is usually taken for granted, or simply disregarded, in public procurement studies. In general terms, this approach is correct in that public procurement is not (specifically) designed to prevent distortions of competition between undertakings. However, *issues regarding competition in the market are not alien to public procurement* (Sauter & Schepel, 2009), and need to receive a stronger emphasis (as pointed out long time ago; Sherrer, 1982).

In our view, the relevant element that has so far received very little attention is that *public procurement rules can themselves generate significant distortions of competitive market dynamics* (Kettl, 1993; Amato, 2001; and Anderson & Kovacic, 2009)—and, in so doing, can be largely self-defeating (Spagnolo, 2002), as they can restrict the effective chances for the public buyer to obtain best value (Fiorentino, 2006). Public procurement regulations tend to establish a market-like mechanism that, in most instances, ends up isolating a part of the market—*ie* artificially creating a 'public (sub-)market'—that becomes highly regulated in various aspects (by public procurement rules themselves) and that, in the end, can result in restrictions or distortions of competition that limit the ability of the public buyer to obtain value for money. Hence, in order to promote the efficiency of the procurement activities and value for money (and, ultimately, increased social welfare), *public procurement rules need to be pro-competitive and guarantee that they do not restrict or distort competition in the market* (similarly, Fiorentino, 2007).

Indeed, given that public procurement strongly relies on competitive markets, it is submitted that there is a need to ensure that the design of public procurement rules and administrative practices, while fit and appropriate to promote competition in the narrower sense (*ie* competition *within* the tender or procurement process), do not generate unnecessary distortions to competition in its broader sense (*ie* competition *in the market* where public procurement activities take place). Therefore, it is our view that making these broader competition issues explicit and exploring the ways in which market distortions generated by public procurement rules and administrative practices can be avoided or minimized—*ie* how public procurement can be designed in a more pro-competitive fashion—is clearly relevant in the field of public procurement and might result in a significant improvement of this body of economic regulation.

This paper aims to contribute to the debate on the relevance and implications of competition considerations for the proper design of public procurement systems (*ie* for a design that promotes social welfare) and advocates a strong pro-competitive approach to public procurement design. The next section briefly describes the main types of (anti)competitive effects that public procurement regulations can generate in the market (that is, the restrictions that procurement law design should aim to prevent). Turning to the example of the European Union, the following section analyzes a possible regulatory response and describes how the EU Public Procurement Directives have an embedded competition principle that (i) aims to minimize those competitive distortions and (ii) serves as the basis for a competition-oriented enforcement of the EU procurement rules. The final section extracts some conclusions or general criteria that might

be useful to inform the design of competition-oriented public procurement systems that aim to foster social welfare.

POTENTIAL DISTORTIONS OF MARKET COMPETITION DERIVED FROM THE PUBLIC PROCUREMENT SYSTEM

The Need to Overcome the 'Public Market Paradigm' for a Proper Appraisal of the Competitive Distortions of Procurement

As has been briefly mentioned, public procurement rules and practices can generate a major impact on the markets where the public buyer sources goods and services. However, these effects on competition remain largely obscure if public procurement is analyzed in isolation, on the basis of a '*public market paradigm*' where the government would be the only buyer for the given goods or services and its decisions would not be led (exclusively) by economic considerations (*ie* price levels and the associated budgetary constraints) but only by the pursuance of the public interest (defined in very broad terms) (for a description, see Bovis, 1998 & 2005). In our view, such a general line of analysis might be misleading—given that some of the basic assumptions of the model are questionable—particularly inasmuch as even those prototypical 'public markets' do not constitute solid realities, but group a large number of heterogeneous markets. This overly-simplified description of the markets where public procurement takes place does not reflect reality (or, at least, is limited to very few markets, mainly related to defense procurement) and tends to distort the normative analyses on the design of the procurement system (similarly, Trepte, 2007). The analysis and reasoning based on an 'artificial' public market construction results in overlooking and omitting of all the effects (both positive and negative) that public procurement can generate in the 'natural' markets where the public buyer is really developing its procurement activities—which can be better appraised through a more careful consideration of the types of markets where the public purchaser sources goods and services

It is our view that a substantial part of public procurement activities take place in *commercial markets*, where the public buyer is the main (but not the only) buyer and where it faces demand competition from fringe buyers (be it companies, consumers, or both)—so that, in principle, the public buyer does not determine market dynamics more than any other economic agent with equivalent buying power (since suppliers are relatively free to redirect their goods and services from public to private demand). In these markets, the commercial practices of the public buyer should be analyzed according to the same general rules applicable to other undertakings that eventually hold buying power and, therefore, can generate substantially

identical competitive distortions—*ie* in commercial markets, public power buyers should be subject to the same checks and rules that any other power buyers face. Therefore, it will be useful to analyze the potential distortions on competitive dynamics that procurement activities can generate in '*publicly-dominated markets*', where the public purchaser holds significant buying power.

Potential Competitive Distortions Generated by Procurement in 'Publicly-Dominated Markets'

The analysis of the economic effects that public procurement can generate on market dynamics has remained substantially unexplored (OECD, 1999; Thai, 2001)—and empirical studies are particularly lacking. However, the analyses conducted so far show clearly that the exercise of buying power in the conduct of public procurement activities (either willingly or unnoticed, as a result of public procurement rules) can generate significant competition distortions in the markets where goods and services are sourced (OFT/ •econ, 2004; OECD, 2007; Mathisen & Solvoll, 2008; for further references, see Sánchez Graells, 2009).

The kinds of market distortions generated by public procurement regulations, *a priori*, seem to be primarily of two types. On the one hand, by means of price and non-price distortions, they generate a direct negative impact on market competition dynamics (primarily on the form of a *waterbed or knock-on effect*) and impose an efficiency loss on society (*ie* a direct negative externality) (i). On the other hand, they set up a market structure that, under certain conditions, increases the likelihood of collusion amongst tenderers and can further reduce the level of competition in the market by diminishing the long-term incentives of potential bidders to compete (*ie* generate derived negative externalities) (ii). Furthermore, some procurement procedures can generate additional market distortions (iii).

(i) The term '*waterbed effects*' is normally used to refer to situations whereby differential buyer power results in a gain for some buyers at both the relative and absolute expense of other buyers (Dobson, 2005; Inderst & Valletti, 2008). Ultimately, as a result of this waterbed effect, welfare is likely to be reduced—be it a result of increases in prices for the rivals of the power buyer (assuming certain additional conditions leading to price discrimination are met) (Dobson & Inderst, 2007 & 2008; Foer, 2007), or be it a result of the exit of weaker suppliers or fringe competitors from the market (Grimes, 2005; Majumdar, 2006). Indeed, if the rise of a powerful buyer erodes suppliers' profits, then in the long run some suppliers may be forced to exit or merge with other suppliers in order to survive. This may lead, in particular, to a rise in the wholesale prices faced by less powerful buyers (Inderst & Mazzarotto, 2008). As a

result of this additional concentration of the upstream industry and higher wholesale prices, fringe input buyers can eventually be forced to exit the downstream market. The aggregate effect of the reduction in competition in both wholesale and retail markets is very likely to produce a loss of total welfare (Doyle & Inderst, 2007; Dobson & Inderst, 2007 & 2008; Inderst & Valletti, 2008).

Public procurement both in final products markets and in wholesale markets can generate market distortions of a 'waterbed-type' (BundesKartellamt, 2008) that can result in higher prices in the non-public fringe of the market (and, particularly, for consumers) (as empirically tested by Scott Morton, 1997; and Duggan & Scott Morton, 2006). In order to properly assess when the public buyer is to be found in such a competitive position, the characteristics of the sourced goods or services (or of the admissible suppliers) that are 'created' by public procurement regulations themselves should be disregarded because, in the absence of public procurement regulations, the public buyer would be shopping in the exact same markets as undertakings and consumers do. For instance, when the public buyer sources information and communication technology (ICT) products, the fact that it restricts the potential supply to vendors able to prove they have more than a given number of years' experience does not generate a separate 'public' market for ICT products where only those vendors and the public buyer are active (*ie* an exclusive or monopsonistic market). This phenomenon should be analyzed as a truncation of the supply by the public buyer—either willingly, or as a result of mandatory public procurement regulations—whereby it 'skims' the market offer and leaves the fringe buyers, for instance, more exposed to dealing with less experienced suppliers (and, from the opposite perspective, limits relatively inexperienced suppliers' market opportunities to serving non-public buyers). By selecting the type of vendors that have access to public demand, the public buyer is setting the framework for the appearance of waterbed effects. For instance, in the example, excluded vendors might need to raise their prices in the non-public tranche of the market in order to be able to recoup their fixed costs. Also, as they have a relatively large part of their production committed to serving the public buyer, experienced vendors can indulge in charging (or be pressed to charge, depending on the commercial conditions that they can extract from the public buyer) supra-competitive prices in the non-public tranche of the market (Sherrer, 1981). Alternatively, and depending on the specific concurring circumstances, public contractors can find themselves in a good position to undercut their rivals' prices in the non-public tranche of the market, as a part of a predatory strategy to prevent them from acquiring the required experience and, thus, becoming effective competitors in the public tranche of the market. As a result of either of these strategies, the competitive dynamics of

the market will be altered—compared to the conditions prevailing in a scenario free from public procurement rules and requirements—and, in a significant number of cases, the result will be negative from a welfare perspective.

In these cases, the waterbed effect does not necessarily derive from a strategy of exercise of buying power on the part of the public buyer, but more probably from similar price and non-price effects generated—maybe unnoticed and most probably unwillingly—by public procurement regulations and administrative practices. In these cases, it is remarkable that *the expected welfare losses derived from competition-restricting public procurement rules and practices could be larger than in the case of a 'willful' monopsonist,* since the public buyer might not be in a position to capture most of the economic rent extracted from suppliers and other buyers—particularly where the economic rent generates additional compliance costs that are not fully recoverable through higher procurement prices by public contractors, or when price increases in the non-public tranche are only partially captured as producer surplus by government contractors—in which case, the economic rent generated by procurement regulations will mainly be dissipated in welfare losses as a result of inappropriate or excessive regulation of market activity. Acknowledging the existence of these possible distortions—that result in a welfare loss for society and that, somehow, can also result in a cross-subsidy of public procurement by other economic agents—can help measure the cost of public procurement regulations and, consequently, to improve their design with the aim of reaching superior results in terms of economic efficiency.

(ii) For its part, the fact that *public procurement rules increase the likelihood of collusion* among bidders has been convincingly proven in economic literature (for a recent survey, Klemperer, 2008a & 2008b), and has also been stressed for a long time by legal doctrine (Kovacic, 1990; Trepte, 1993). It is out of question that, under most common market conditions, procurement regulations significantly increase the transparency of the market and facilitate collusion among bidders through repeated interaction (OECD, 2006; Albano *et al*, 2006; Kovacic *et al*, 2006). This key finding has not generated as strong a legislative reaction as could have been expected—and most public procurement regulations still contain numerous rules that tend to increase transparency and result in (or at least facilitate) competition-restrictive outcomes (such as bid disclosure, pre-bid meetings, restrictions on the issuance of invitations to participate in bidding processes to a relatively pre-defined or stable group of firms, etc.). However, choosing the adequate level of transparency is a complicated task—also because it has major implications as regards other objectives of the public procurement system (oversight, anti-

fraud, etc.)—and the generation of a pro-collusion scenario seems intrinsic to the system. In this regard, the initiatives currently in place to address the potential collusion amongst tenderers seem substantially adequate to minimize the effects of the pro-collusive features of the public procurement system (OECD, 2009).

Maybe what is most noteworthy from the perspective of public restrictions and distortions of competition in public procurement markets, the potential for collusion or coordination among public buyers (Winterstein, 1999), and other non-collusive effects on bidders' and buyers' behavior derived from price signaling (Dufwenberg & Gneezy, 2002), have received significantly less attention by both legal and economic doctrine. Collusion or coordination among public buyers might be a result of public procurement rules or practices when they impose a certain degree of harmonization or homogenization of the economic conditions under which different (independent) public bodies conduct their procurement activities. For instance, if the maximum reservation prices used by (otherwise) independent public buyers are set by a centralized unit, the effect on prices will be the same as that derived from a private buying cartel. Similarly, even if there is no express or formal centralization of pricing conditions, a problem of 'collusion' between buyers (loosely defined) can arise, since they are (or can be) fully informed of the prices paid in previous tenders by other public buyers. It is similar to an exchange of information between public purchasers (which, in the private sector, would be tantamount to a buying cartel). This potentially negative effect, derived from a limitation of the (already scarce) competition amongst public buyers that could be expected to take place in publicly-dominated markets, has been largely omitted in the analysis of competition dynamics in public procurement markets. The same reasoning applies when independent buyers are forced to use common technical specifications, or when any other price or non-price aspect of their demand is (unduly) harmonized by regulations or administrative practices in the public procurement field. Therefore, in view of these economic insights, the transparency generally associated to public procurement procedures should be minimized (to the maximum possible extent) when designing the procurement system.

(iii) Finally, *additional competition distorting effects* can derive from tendering procedures which generate significant flows of information between the candidates and the public buyer, and amongst candidates. In cases where the procurement process facilitates the exchange of information that would otherwise remain confidential to the parties, there seems to be scope for further restrictions of competition—both generated by the public buyer or as a result of coordination or collusion amongst candidates. That seems to be the

case of particularly complex tender procedures. Therefore, public procurement regulations—particularly when they opt for apparently flexible solutions that generate increased scope for exchanges of information or technical leveling—can lead to additional competition distortions, which should be taken into account and minimized in order to construct a more competition-oriented system.

Such Potential Distortions Justify a Regulatory Response that Protects Effective Competition in Public Procurement

On the basis of the previous discussion, public procurement can be conceptualized as a market-like regulatory instrument that can generate several types of (derived) market failure. Public procurement regulations are susceptible of generating both direct and indirect effects on competition dynamics in the markets concerned. As regards direct effects, the market behavior of the public buyer can give rise to *waterbed effects* that are similar to those generated in non-public instances of the exercise of buyer power. Public procurement can also generate indirect effects through the setting of a scenario particularly prone to collusion, both on the demand and the supply side, as a result of the transparency of the tendering procedures and the associated price signaling. Finally, certain specific procurement procedures that generate an increased scope for the exchange of information between the public buyer and the candidates (and, indirectly, amongst the latter) can generate additional effects of technical leveling and price signaling. In our view, the existence of all such potential negative competition effects that can be detrimental to social welfare constitutes a solid normative basis for the development of a more competition-oriented public procurement system—*ie* requires a regulatory response. The following section will focus on the solution adopted in the European Union, as an example of regulatory response to the potential distortions of competition generated by public procurement.

A POSSIBLE REGULATORY RESPONSE: THE PRINCIPLE OF COMPETITION EMBEDDED IN EU PUBLIC PROCUREMENT DIRECTIVES

The Principle of Competition as a Foundation of the EU Public Procurement System

Given its strong orientation towards the development of the internal market, as well as the strong links between internal market and competition rules in the European Union (Baquero Cruz, 2002; Szyszczak, 2007; Sauter & Schepel, 2009)—the EU Directives on public procurement have always had a very strong pro-competitive bias (Boncompagni, 1996). The promotion of effective competition

in the public procurement field—or, put otherwise, the opening up of public procurement markets to competition, has been a constant goal since their inception in the 1970s, across the four generations of EU public procurement Directives. The development of effective competition in the field of public contracts was expressly stated as an objective in the preamble to the previous generation of Directives; and such an express objective is also contained in the preamble to current Directives—see recital (9) in the preamble to Directive 2004/17 and recitals (2) and (36) in the preamble to Directive 2004/18. Moreover, current EU public procurement Directives have numerous references to the preservation and promotion of undistorted competition as one of the basic goals and principles of this regulatory body. See recitals (2), (4), (8), (12), (13), (15), (29), (31), (36), (41) and (46) in the preamble to Directive 2004/18, as well as recitals (9), (11), (15), (20), (21), (23), (32), (38), (40), (41), (42) and (55) in the preamble to Directive 2004/17.

Even further, many of their provisions make express reference to the fact that contracting authorities must refrain from adopting certain procedures or applying certain rules if doing so would limit or distort competition. Indeed, this constraint in the design and implementation of public procurement rules is expressly stated by the current EU public procurement Directives, particularly in relation with new procedures and institutions, such as the competitive dialogue, electronic tendering, dynamic purchases, or framework agreements; as expressed by articles 29(7), 32(2), 33(7) and 54(8) of Directive 2004/18 and articles 14(4), 15(7) and 56(9) of Directive 2004/17—all of which expressly prohibit contracting authorities to resort to these types of contracts and procedures if that could result in a limitation or distortion of competition. Also, article 35(4) in fine of Directive 2004/18 and article 49(2) in fine of Directive 2004/17 allow for derogations on the rules of publicity and advertisement where the release of such information might prejudice fair competition between economic operators, public or private. Therefore, it is submitted that it is clear from all these provisions of the current EU public procurement Directives that they are founded on the conceptual basis that contracting authorities must refrain from adopting certain procedures or applying certain rules if doing so limits or distorts competition (similarly, Arrowsmith, 2005). Along the same lines, it can be considered that the specific procedure for establishing whether a given activity takes place in competitive markets—and, consequently, can be excluded from the scope of Directive 2004/17 because '*the activity is directly exposed to competition on markets to which access is not restricted*' [*ex* art. 30(1) Directive 2004/17]—is a further indication of the clear link between public procurement rules and competition concerns.

In general, then, it is submitted that the EU public procurement Directives have an *embedded competition principle* (i), that constitutes the link between public procurement law and competition law (ii), and that has major implications for the design and construction of the EU public procurement rules (iii).

(i) *Recognition and Scope of the Competition Principle*. As already mentioned, no doubt should be cast on the existence of a *competition objective* embedded in the EU public procurement Directives—which has clearly and consistently been declared as such by the case-law of the Community judicature (C-538/07 – *Assitur*, ¶ 25; C-213/07 – *Mikhaniki*, ¶ 39; C-454/06 – *Pressetext*, ¶ 31). Indeed, the ECJ case law has repeatedly held that the Directives are designed to eliminate practices that restrict competition in general and to open up the procurement market concerned to competition—*ie* to ensure free access to public procurement, in particular for undertakings from other member States. The reasons behind this pro-competitive approach to public procurement are that effective competition is expected firstly to remove barriers that prevent new players from entering the market, secondly to benefit contracting entities which will be able to choose from among more tenderers (and, thus, will be more likely to obtain value for money), and, finally, to help maintain the integrity of procurement procedures as such (AG Poiares Maduro, C-250/07 – *Commission v Greece*, ¶¶ 11 & 17).

In our view, the pursuit of this primary objective has generated or resulted in the emergence of a *competition principle* that underlies and guides (or, in our opinion, should guide) the rules and regulatory options adopted by the EU public procurement system in trying to achieve the objective of effective competition in public procurement markets (Sánchez Graells, 2010). The distinction between the competition *goal* persistently and emphatically stressed by the EU Directives and their interpreting case-law, and the ensuing competition *principle* hereby identified might to some seem blurry, since they largely imply each other or, in other terms, hold a *biunivocal or interconnected relation*. The close link between the competition objective and the competition principle is acknowledged and, for our analytical purposes, the principle of competition will be understood and referred to as the 'translation' or 'materialization' of the competition goal clearly and undoubtedly pursued by the EU public procurement Directives.

It should be acknowledged that the principle of competition has remained largely implicit both in public procurement regulations and in their interpreting case law, but it seems to be receiving an increasing degree of attention in the enforcement of the EU public procurement regime. Even if, arguably, it has not yet been explicitly applied, nor fully enforced by the Community judicature, such a

competition principle has informed the public procurement case law and has contributed to establishing the proper boundaries for the development of public procurement activities by member States' contracting authorities. As the European Court of Justice (ECJ) observed, '*all the requirements imposed by Community* [public procurement] *law must* […] *be applied in such a manner as to ensure compliance with the principles of free competition and equal treatment of tenderers and the obligation of transparency*' (C-286/99 – *Lombardini and Mantovani*, ¶ 76; emphasis added). In short, in our view, the principle of competition has always formed a basic part of public procurement regulation in the EU and constitutes one of its fundamentals. This point of view has been consistently shared by several opinions of Advocates General (*e.g.* AG Stix-Hackl, C-247/02 – *Sintesi*, ¶¶ 32 & 33), as well as by an increasing body of scholarly commentary (Trepte, 2004; Arrowsmith, 2005; Benacchio & Cozzio, 2008). It is fitting to recall here a recent statement by the ECJ to the effect that '*that the Community rules on public procurement were adopted in pursuance of the establishment of the internal market, in which freedom of movement is ensured and restrictions on competition are eliminated*' (C-538/07 – *Assitur*, ¶ 25; see also C-412/04 – *Commission v Italy*, ¶ 2).

In light of the above and as already pointed out, it is our opinion that *the principle of undistorted or free competition has always formed a basic part of EU public procurement rules, that it constitutes one of its fundamentals, and that it offers a proper legal basis upon which to build the basic elements of a more pro-competitive public procurement system*. The boundaries of the competition principle will now be explored.

According to its most elaborated construction so far (AG Stix-Hackl, C-247/02 – *Sintesi*, ¶¶ 34–40), the competition principle embedded in the EU public procurement Directives—which is to be conceived of as an independent principle (AG Léger, C-94/99 – *ARGE*, ¶ 95 fn 36)—seems multi-faceted and, potentially, can fulfill at least three protective purposes. First, it is aimed at relations between undertakings themselves and requires that there exists parallel competition between them when they participate in the tendering for public contracts. Second, it is concerned with the relationship between the contracting authorities and the tendering undertakings, in particular in order to avoid abuses of a dominant position—both by undertakings against the contracting authorities (through the exercise of market or 'selling' power) and, reversely, by contracting authorities against public contractors (through the exercise of buying power). Third, the *principle of competition is designed to protect competition as an institution*. Finally, as a complement to the previous functions or as an expression of the competition principle,

EU public procurement Directives set particular rules that operationalize the competition principle in different phases of the public procurement process—such as transparency rules, rules on technical specifications, provisions on the selection of undertakings and on the criteria for the award of contracts, information disclosure rules, etc.

Even if this general approach is appropriate, a closer examination seems to indicate that, of the three stated functions of the competition principle in the public procurement arena, only the latter is of distinguishing relevance—*only what has been termed 'protection of competition as an institution' constitutes the proper content for the competition principle embedded in EU public procurement law*—since currently there is no specific competition rule that develops that function with a general character. By 'protection of competition as an institution', it is submitted that direct reference is made to the general objective of the Treaty on the Functioning of the European Union (TFEU) of guaranteeing a system ensuring that competition in the internal market is not distorted (art. 119; Protocol No. 27) and, more generally, to the ensuing general principle of competition (Tridimas, 2006; Odudu, 2006). In our opinion, EU public procurement Directives should be conceived of and configured as a body of rules developed on the basis of the principle of undistorted competition in the internal market. Or, more clearly, *the competition principle embedded in the EU public procurement Directives is no more and no less than a particularization of the more general principle of competition in EU law*. In this way, the relevance of the competition principle in the field of public procurement is stressed, since its inclusion amongst the basic principles of public procurement regulation seems to imply the existence of a stronger link of this body of regulation to this general principle of EU law than in the case of other regulatory bodies. It is submitted that placing the principle of competition at the basis of the EU public procurement rules reinforces its importance.

In furtherance to the above, it is our view that the competition principle embedded in EU public procurement Directives has two dimensions. In its *positive dimension*, public procurement rules are guided by a fundamental competition principle in that they are designed to abolish protectionist purchasing practices by Member States that result in a segmentation of the internal market and, consequently, to foster transnational competition for public contracts, as well as increased domestic competition for the same contracts. In our view, maybe of a greater relevance—although so far less explored—is an envisageable *negative dimension* of the competition principle embedded in EU public procurement Directives. From this perspective, competition requirements should be understood as

determining that public procurement rules have to be designed and implemented in such a way that existing competition is not distorted. In other words, it is submitted that public procurement rules cannot generate distortions in the dynamic competitive processes that would take place in the market in their absence. Or, even more clearly, public procurement rules must not distort competition between undertakings. This fundamental competition principle embedded in the public procurement Directives could be defined or phrased in these terms: *public procurement rules have to be interpreted and applied in a pro-competitive way, so that they do not hinder, limit, or distort competition. Contracting entities must refrain from implementing any procurement practices that prevent, restrict or distort competition.*

Additionally, it is our view that this mandate must be considered a well-defined obligation to all member States' contracting authorities, and not a mere programmatic declaration of the EU public procurement Directives. As has been rightly stressed, the evolution of the EU Directives on public procurement has progressively reduced the area of discretion left to member States (Arrowsmith, 2006)—and consequently the general principles and mandates contained in the EU public procurement Directives should suffice to effectively constrain member States' purchasing behavior, or to substantiate a declaration of their breach of EU law if they behave otherwise. Hence, from this negative perspective, public procurement rules and practices need to be measured with the yardstick of the competition principle to ensure that they do not result in restrictions of competition or, in other terms, that they do not generate the effects that competition law seeks to prevent. In the end, as was clearly stated, '*the principle of competition is designed to protect competition as an institution*' (AG Stix-Hackl, C-247/02 – *Sintesi*, ¶ 36). This issue raises the need to clarify the relationship between 'general' competition law and the public procurement Directives.

(ii) *The Competition Principle as the Link between Public Procurement Law and Competition Law.* It has already been mentioned that the principle of competition embedded in the EU public procurement Directives makes direct reference to the basic TFEU objective of guaranteeing a system ensuring that competition in the internal market is not distorted and to the ensuing general principle of competition in EU law. Consequently, an apparent link between the competition considerations within the public procurement field and 'general' EU competition rules emerges—since both ultimately share the same goal and must be shaped in conformance with the same general principle. In our opinion, public procurement rules seem insufficient to become an *alternative* to competition rules and a different type of relationship seems more

adequate to properly conceptualize the existing link between competition and public procurement. It is submitted that competition and public procurement remain largely *complementary* and provide each other with useful interpretative criteria. Moreover, an adequate enforcement of each of these sets of economic regulation reinforces the effects of the other. On the one hand, a public procurement system properly based on the competition principle can complement current competition rules and tackle certain types of publicly-generated competition distortions that are not captured by current EU competition law (Sánchez Graells, 2009 & 2010). On the other hand, the criteria and tools of analysis usually applied in the enforcement of competition law can inform and guide the concrete application of the competition principle through more specific public procurement rules. Therefore, the competition principle embedded in public procurement Directives should be understood as the necessary link for the approximation and consistent development of both sets of economic regulation, or as the gateway through which principles and criteria generally related to the protection of undistorted competition in 'non-public' markets (*rectius*, in relation with non-public buyers) can be brought to life in public procurement markets to discipline the purchasing behavior of the public buyer.

(iii) *Implications of the Competition Principle for the Design and Construction of EU Public Procurement Rules*. The legal implications of the abovementioned competition principle are manifold and particularly condition the way in which EU public procurement Directives should be interpreted or self-constructed, and the real alternatives that member States have for their transposition (*ie* their introduction into their respective domestic legal systems)—which has to ensure the existence of a pro-competitive public procurement system and should not jeopardize the achievement of the basic competition objective. What is possibly still more relevant is the fact that the existence of the competition principle deeply conditions the way in which domestic public procurement legislation has to be interpreted. In our view, according to the doctrine of consistent interpretation developed by the ECJ, Member States are under an almost absolute obligation to guarantee that domestic legislation is interpreted and applied in a manner that is consistent with EU law, and to ensure that the Community goals and intended effects of directives are attained through national legislation. More specifically, then, *as a matter of EU law the interpretation and enforcement of Member States' public procurement rules by national courts and authorities must be consistent with the fundamental principle of competition embedded in the EU public procurement Directives*, and so Member States must ensure that practices and decisions ensuing from domestic public procurement legislation do not result in restrictions of market competition. Hence, domestic

anti-competitive procurement rules and practice run contrary to EU public procurement law—that is, anti-competitive public procurement is specifically proscribed by EU public procurement law. Moreover, given that the principles that derive from the TFEU must be respected by the Member States in the conduct of procurement activities not covered by the Directives, *the pro-competitive requirements imposed by EU public procurement law are automatically extended to all public procurement rules and practice of the Member States*, including procurement activities not or not fully covered by the EU Directives. Finally, for the sake of completeness, a residual role for the principle of competition can also be envisaged in cases of new or totally unregulated public procurement practices (*in dubio, pro concurrentia*).

Some Extensions and Particularizations of the Principle of Competition Embedded in the EU Public Procurement Rules

As a specification of the general implication briefly mentioned above, a review of the different types of competition distortions that can arise from public procurement rules and practices from the perspective of competition considerations allows for the extraction of certain criteria aimed at ensuring compliance with the principle of competition and the development of a more competition-oriented public procurement system—such analysis is conducted elsewhere (Sánchez Graells, forth.), but the main conclusions are reported here. The main pro-competitive criteria can be summed up as follows.

(i) *The Design of the Tender Procedure Should Ensure Broad Access by All Potentially Interested Undertakings.* As regards the rules regulating access to the public procurement process, public tenders and the applicable requirements should be designed in such a way that access to the tender is as unrestricted as possible and that the procedure is as open as possible—subject to compliance with basic proportionality requirements, so as not to impose excessively burdensome obligations on contracting authorities.

Contracting authorities are under no obligation to resort to the market or to call on undertakings to carry on public interest activities, since there is no obligation under EU law to carry on competitions between the public and the private sector. However, if the contracting authority decides to entrust the development of any activities to undertakings—in general, to source goods, works or services from the market—it should do so in accordance with EU public procurement rules or their basic principles (particularly avoiding strategic behavior oriented towards circumventing those rules and principles by means of their jurisdictional limitations and, more specifically, by avoiding the value thresholds that trigger their application) and not resort to closed or non-competitive procedures

in cases other than those expressly regulated by public procurement Directives. Moreover, the conditions that allow contracting authorities to award contracts through other than open and restricted procedures should be interpreted narrowly. In general, contracting authorities should conduct their decisions regarding the applicable tender procedures with the main aim of avoiding the generation of negative impacts on market dynamics. Consequently, they should tend to run tender procedures in the most open possible manner, subject to an analysis of proportionality between the costs and difficulties associated to conducting the tender according to the rules of open or restricted procedures and the eventual restrictions of competition derived from resorting to other types of (less competitive) procedure.

Also in order to keep access to the public procurement process as open as possible, contracting authorities should minimize the cost of participation—particularly in the form of entry fees, such as charges associated to the sale of bid documents. These charges should be set at the lowest possible level and, in any case, be proportionate to the real cost of document preparation. Furthermore, contracting authorities should ensure that all relevant information is available and promptly disclosed to all potentially interested participants in the tender on a non-discriminatory basis and ready from the outset—except where exceptional circumstances concur—so that no tender procedure is unnecessarily launched before all the relevant documentation is in place. Along the same lines, and with the purpose of reducing the costs and barriers to access the tender procedure, requirements of bid securities should be minimized and adjusted to a level that is proportionate to the actual risks intended to be covered and, as a complementary criterion, to the value of the contract. By reducing administrative burdens and financial costs of participation, contracting authorities can foster competition—particularly by small and medium enterprises (SMEs)—and, consequently, their decisions should avoid imposing disproportionate and unnecessary requirements.

Along the same lines, and in order not to unduly limit participation in the tender procedure by potentially interested undertakings, contracting authorities should minimize the grounds for exclusion of potential bidders to those circumstances that can generate actual distortions of competition. In this regard, the grounds specifically regulated in the Directives should be interpreted and applied in a proportionate manner (*ie* narrowly constructed, particularly if there is no significant competitive advantage to be gained by tenderers affected by the potential ground for exclusion) and the generation of additional grounds for the exclusion of tenderers should be oriented towards ensuring that competition is not distorted. In this regard,

breaches of competition law should always be considered instances of grave professional misbehavior and, consequently, offer an adequate basis for the exclusion of tenderers (subject to suspension and debarment rules).

As regards the qualitative selection of candidates, particularly in the cases where a restriction on the number of participants applies or where contracting authorities set up official lists of contractors or systems of certification of contractors, the Directives clearly impose an obligation to keep the applicable requirements to a minimum, so that they are proportionate and directly related to the subject-matter of the contract, and tend to ensure participation by a number of tenderers that generates genuine competition. Such proportionality requirements not only affect each of the requirements individually taken, but also the set of qualitative selection requirements analyzed together. In particular, requirements regarding the previous experience of candidates have to be proportionate, take into account all proven experience that can be of relevance for the development of the contract, and they cannot include criteria related to the specific past performance of contractors with this or other contracting authorities. In general, contracting authorities should adopt a neutral and possibilistic approach to the determination of economic operators' compliance with qualitative selection criteria, and guide their decisions by the need to ensure that candidates are able to deliver to the minimum (proportional) specified standards. In order to avoid early restrictions of competition, other considerations such as their ability to excel in the performance of the contract or to offer particularly interesting or advantageous solutions should be deferred to tender evaluation and analysis according to the set award criteria.

In relation to the establishment of technical specifications, the Directives clearly adopt an anti-formalist approach based on technical neutrality that has as its main objective avoiding the creation of unjustified obstacles to the opening up of public procurement to competition. Therefore, contracting authorities should refrain from using excessively specific or discriminatory technical specifications, avoid setting excessively demanding technical specifications ('gold plating'), and adopt a neutral and flexible (*i.e.* 'possibilistic') approach in the determination of technical and/or functional equivalence of (alternative) solutions. Along the same lines, where it does not generate a disproportionate increase in the complexity or cost of the procedure, contracting authorities should allow for the submission of variant tenders, so as to allow for the maximum possible technical openness of the tender procedure.

Similarly, in order to allow for the participation of the maximum number of interested bidders, contracting authorities should adopt a flexible approach towards teaming and joint bidding—subject to compliance with general competition rules by the bidders. In this regard, as long as teaming and joint bidding contribute to intensifying competition within the tender without generating significant distortions to competition in the market concerned, contracting authorities should promote it. In the particular instance of participation by consortia, this flexible approach should be made extensive to the rules regulating their composition, changes in the consortia, etc.—unless its implementation is materially negative for the development of the tender process—so that participation by consortia is fostered to the maximum extent permitted by competition law. A similarly flexible approach should be adopted as regards the prohibition of multiple-bidding by a single entity or by entities amongst which a relationship of control exists, so that all the tenders in which they participate are not unnecessarily excluded—at least where the analysis of the specific circumstances of the case shows that competition is not altered in a material way.

A further set of requirements that have a major impact on the openness or accessibility of the tender procedure—and, hence, should be interpreted in a pro-competitive way—concerns the decisions regarding the aggregation of requirements into single contracts, the division of contracts in lots, and the rules regulating 'package' bidding for different lots by a single tenderer. In this regard, the general criteria should be that—whenever feasible and as long as it does not generate excessive complexity or disproportionate costs to the contracting authority—contracts should be divided in an appropriate number of lots (having in mind the effects on potential collusion by tenderers) and conditional and packaging bidding should be permitted, so as to promote competition for the contract. The opposite approach should be adopted as regards induced or mandatory subcontracting—which is a substitutive device for the 'break-up' of the object of the contract. Given the potential distortions of competition that can arise from subcontracting requirements, contracting authorities should largely refrain from mandating or inducing subcontracting.

Finally, as regards contractual systems that are based on the aggregation of contracts (over time)—such as framework agreements and dynamic purchasing systems—and the electronic auctions through which they can be implemented, similar criteria should be applied in their design, so as to ensure that they do not distort competition and that the restrictions applicable to the design of all other tender procedures are not circumvented.

(ii) *The Rules Regarding the Evaluation of Bids and the Award of the Contract Should Ensure Equality of Opportunity, Neutrality of Assessment and Undistorted Competition.* There are several aspects of the evaluation and award process that seem particularly prone to the generation of distortions of competition—both *within* the tender procedure, and *in* the market concerned. In this regard, it is worthy to stress the importance of respect for the principle of competition to ensure that the evaluation of bids and the award of the contract is conducted in a neutral and impartial way, and that these activities are not unnecessarily constrained by formalistic requirements but rather tend to ensure the proper appraisal of tenders on substantive grounds.

In order to guarantee such neutrality and equality of opportunity, contracting authorities are under a special duty when assessing the tenders submitted by apparently advantaged parties, so as to ensure that competition has not been altered. In the same vein, contracting authorities should ensure that evaluation and award decisions are conducted on an arm's length basis, particularly as regards the appraisal of tenders submitted by incumbent contractors (in order to avoid path dependence or the unwarranted consolidation of commercial relationships). In this regard, the treatment of switching costs in public procurement procedures poses a specific difficulty. Nonetheless, it would be fully compliant with the principles of competition and non-discrimination to establish a clear non-absolute duty to neutralize avoidable incumbency advantages (mainly, switching costs), particularly by adapting award criteria to take them into due account.

Award criteria, for their part, generate the biggest possibilities for departure from the required neutral and pro-competitive approach to public procurement. The selection and weighting of the criteria for the award of the contract largely determine the outcome of tender procedures and, consequently, merit special consideration from a competition perspective. Hence, it should come as no surprise that EU public procurement rules expressly require that award criteria ensure compliance with the principle of equal treatment and guarantee that tenders are assessed in conditions of effective competition. In order to limit the possibilities of distortions of competition arising (even inadvertently), award criteria must be relevant, specifically linked to the subject-matter of the contract, allow contracting authorities to assess overall which is the most economically advantageous offer (unless the contract must be awarded to the lowest-priced tender) in an objective, transparent and non-discriminatory way, and be weighted in a clear manner that adequately reflects their relevance for the specific contract. Moreover, they should be interpreted and applied in a neutral and objective fashion and according to evaluation rules that properly

reflect the degree of compliance of each tender with the set criteria. In particular, the proper application of the rules regulating award criteria and their application should exclude restrictions derived from award criteria that result in the *de facto* exclusion of tenderers or the advantage of some tenderers over others, and that depart from the general requirement of technical neutrality. Moreover, award criteria should generally not be based on non-quantifiable or subjective requirements and, where required, such subjective considerations should be treated as objectively as possible. Finally, given the uncertainties that they generate, the use of forward-looking award criteria should also be avoided inasmuch as possible.

As closely related issues, the treatment of non-fully compliant bids and the admission of variant tenders can contribute to introducing flexibility in the application of the award criteria regulating a given tender. In this regard, contracting authorities should allow for the submission of variants and not automatically reject non-fully compliant bids, as long as it is feasible and proportionate in relation to the subject-matter of the contract and the applicable award criteria. Along the same lines, but from the opposite perspective, when the variance between bids and tender requirements is significant (*ie* in case of apparently abnormally low tenders) and generates a risk of non-compliance or of financial instability for the contracting authority, the contracting authority is bound to reject such materially non-compliant tenders. In these cases, the principle of diligent administration requires the authority to reject the tender unless it can motivate a decision to accept it on the basis of overriding legitimate reasons and as long as that does not generate discrimination or distortions of competition. Finally, subject to strict necessity and proportionality requirements, contracting authorities can impose *absolute* award criteria, or awarding constraints, so that no tender that does not meet those particular requirements (in full) can be accepted. The imposition of such constraints should, in any case, comply with the same requirements as other award criteria, particularly as regards the need to guarantee that tenders are assessed in conditions of effective competition.

In order to prevent the circumvention of the previous restrictions, and to continue ensuring neutrality of approach and equality of opportunity, contracting authorities have a very limited capacity to modify the terms of the call for tenders and to require or authorize modifications of the tenders submitted prior to or immediately after the award of the contract. As a result of those restrictions, under certain circumstances, contracting authorities could find it in their interest to cancel the tendering procedure. However, such a decision cannot be made without due consideration and should be based on sufficient objective reasons.

(iii) *After the Award of the Contract, the Rules Regarding its Implementation, its Revision and Eventual Retendering, as well as the Procedures for the Challenge of Award Decisions Should Continue to Ensure Undistorted Competition.* Once the contract is awarded, the principle of competition basically requires that the regime applicable to the contract—particularly as regards the amendment of its basic elements—does not allow for the circumvention of the restrictions applicable to the design of the procurement process and the award of the contract. In this regard, some of the restrictions applicable in previous phases of the tender procedure are equally applicable—in amended or adjusted form—post-award. More specifically, contracting authorities are under similar duties to minimize the financial burden of the contract, have very limited power to renegotiate and amend substantial elements of the contract—including its scope, price and delay, which are subject to special rules that must be construed narrowly—and also have limited discretion as regards the (early) termination of the contract and its re-tendering. Moreover, the system should ensure the existence of effective bid protest mechanisms and remedies that guarantee that competition considerations are taken into due account and that distortions of competitive dynamics can be prevented or corrected effectively.

(iv) *The Exercise of Public Buyer Power Should Be Limited as Necessary to Avoid its Abusive Exercise, so that Public Contracts Reflect Normal Market Conditions.* Even where there is no clear connection to particular procedural aspects of the public procurement activity, the exercise of public buyer power should be constrained by the general obligation of contracting authorities not to prevent, restrict or distort competition in the markets concerned. In general, contracting authorities are under a duty to ensure that public contracts reflect normal market conditions to the maximum possible extent. In particular, contracting authorities should refrain from '*squeezing*' tenderers by obtaining disproportionately advantageous conditions, and should be careful not to distort competition through the rules regarding the transfer of IP rights and know-how and their subsequent use and disclosure of such technology.

(v) Therefore, the *overall conclusion* (or default rule) that could be extracted is that almost every step in the procurement process has potentially distorting implications (of a different degree of relevance) and can be oriented in a pro-competitive fashion. Therefore, in order to promote the development of a more competition-oriented public procurement system, contracting authorities should change perspective (or rather, adopt a more competition-oriented perspective) and take into due consideration the potential effects of their decisions on competition for the contract and in the market

concerned, placing special emphasis on not unduly restricting access to the tendering procedure, on not unnecessarily pre-determining the outcome of the tender procedure, and on guaranteeing that the result of the competitive process is not distorted or circumvented post-award, especially through the conduct of undue renegotiation, amendment, termination or retendering of the contract.

CONCLUSIONS

As the paper has shown, public procurement regulations and administrative practices can generate significant distortions on market dynamics—by means of both direct and indirect effects on the competitive process. Therefore, it has been shown that it would be in the public interest to design public procurement systems in a competition-oriented way, so as to minimize their negative impact on social welfare—and, where possible, to promote its enhancement. One possible regulatory response is to insert a general principle of competition (or an equivalent pro-competitive mandate) that informs all rules and criteria to be applied by the public buyer, and that binds judges (and oversight bodies) in their control of the purchasing activities and, more generally, in the enforcement of public procurement rules. This paper has described the example of the European Union, where the public procurement system is built on the foundations of the principle of competition and where the ECJ has progressively strengthened the role of the competition principle in the shaping of the public procurement system. Hopefully some of the conclusions extracted in relation to the procurement system in the EU will be useful in the (further) development of a competition-oriented public procurement system that promotes social welfare (both in the EU, where the job is not yet completed, and elsewhere).

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