Chapter 19

A Principal-Agent Analysis of Accountability in Public Procurement

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INTRODUCTION

The principal-agent problem has done much in recent years to illuminate diverse legal subjects, such as the management-shareholder relationship in corporations, real-estate markets, insurance, employment, and other real-life situations (Harris & Raviv, 1978; Jensen & Meckling, 1976; Ross, 1973). In a principal-agent relationship, one party – the *agent* – is required to perform some service on the behalf of the other party – the *principal*, who involves the delegation of some discretion and decision-making authority. The problem highlighted by the agency model is that often there will be a divergence between the actual decisions made by agents and the decisions that would maximize the principal's benefits. This divergence arises because, when making a decision, agents also seek to maximize their own self-interest. Therefore, whenever the agent's actions are for the sole benefit of the principal (and thus contribute nothing for promoting the agent's self-interest), he/she will engage in a lower level of effort instead of a high level.

The purpose of this chapter is to apply the principal-agent model in order to provide a positive analysis of accountability in public procurement.[2] More specifically, it explains, in principal-agent terminology, the way in which most domestic procurement systems seek to ensure the accountability of their procurement officials before the government and the general public. In addition, it examines whether international or regional agreements on public procurement have the potential to strengthen the accountability of national procurement officials.

The first part of this chapter examines the problem of accountability through the lenses of the principal-agent problem. It should be stated from the onset that the focus of this chapter is the agency relationship which arises between procurement officials and elected representatives (i.e., the government) and *not* between elected representatives and the general public, which is often discussed in a public choice setting. The second part examines, through the lenses of the agency problem, the methods often utilized by national procurement systems to exercise control over procurement officials. The third part, whilst focusing on the EC public procurement directives, examines the contribution of international or regional procurement regimes to increasing the exercise of control over procurement officials. Part four provides a conclusion.

ACCOUNTABILITY IN PUBLIC PROCUREMENT: AN AGENCY PERSPECTIVE

Maintaining integrity in public procurement is one of the most important pillars of modern national procurement systems (Arrowsmith, Lineralli & Wallace, 2000; Kelman, 1990; Schooner, 2002). Ensuring the accountability of procurement officials is perhaps the most essential aspect of this goal.3 The accountability of procurement officials is not only important from a public or administrative law perspective, but also has economic implications. These economic implications have three main dimensions. Firstly, on the procuring side, a lack of accountability on behalf of procurement officials may lead to additional costs, as non-commercial criteria, such as corruption, favoritism or nepotism, replace the objective commercial criteria, which enable contracting authorities to cut the deal with the best possible terms. Secondly, on the business community side, in the absence of accountability, potential suppliers are less encouraged to value government business and provide high-quality goods and services. This, in turn, distorts incentives in the market place as less efficient suppliers are chosen at the expense of efficient suppliers, who go unrewarded, and are thus unable to remain viable and productive. The third economic dimension of accountability in public procurement concerns the rest of the society, which is affected by the actions of both the government and the business community. The public interest therefore requires that governmental business is done in a manner guaranteeing that expenditures are made in the most economically rational way. This is

required both to save on tax-payers money on the one hand, and to ensure the long-term growth of the market by allocating contracts to the most efficient contractors, on the other hand.

The problem of accountability in the context of public procurement stems from the fact that achieving professionalism requires the delegation of decision-making authority from elected representatives to procurement officials. This is necessary because procurement officials have greater experience and superior knowledge as to what kind of goods, services or works are best suited for the public authority's purposes and how to obtain these requirements on the best possible terms (Trepte, 2004). As McCubbins, Noll and Weingast (1987, p. 247) have observed, delegation of discretionary power from elected representatives to the bureaucracy is likely to occur even in cases where such delegation involves costs. This is because delegation confers a benefit to legislators, allowing them to rely on the bureaucracy to formulate the policies that they themselves would have formulated if they had the knowledge, time and resources to formulate them. Thus by delegating discretionary powers to the bureaucracy, legislators may expand the scope of politically relevant activity available to them.

The problem with delegation however, is that to the extent that the procurement official's personal objectives override those of his principal (the government, the public interest or both), there is a danger that the former will show apathy to the procurement outcome in the best case, or discriminate in favor of family, friends and interest groups, or accept bribes, in the worst case. Shirking and corruption by procurement officials is likely to occur for three main reasons. Firstly, the actions taken by the procurement official, which result in efficiency consequences for the principal, are not always easily observed, and therefore principals may face difficulties in enforcing and monitoring their agents' behavior. Secondly, as already mentioned above, officials will usually possess superior knowledge and expertise on specific issues than their principal. Thus even in the absence of the observation problem, the principal may find it difficult to determine whether the agent's actions actually promote his best interests, or whether his actions are motivated by other self-interest considerations overriding the principal's preferences. Lastly, due to high sums involved and the important economic scope and nature of public procurement as the intersection between the public and private sectors, a considerable attraction is presented for

engagement in corrupted and unethical activities on behalf of procurement officials.

It follows that in the absence of effective control mechanisms, procurement officials are likely to involve some personal preferences, derived from their private interests, career prospects, social contacts, monetary reward or merely an aversion to effort, when making procurement decisions. In the terms of the principal-agent terminology used above, a lack of accountability means that the (procurement) agent is more likely to engage in a low level rather than a high level of effort when performing his tasks. The challenge faced by public procurement regulators therefore, is to ensure that the agency costs which rise when procurement agents carry out tasks for the benefit of their principal, do not exceed the benefit derived from such a delegation of decision-making authority.

CONTROLLING THE AGENCY PROBLEM: THE DOMESTIC LEVEL

The problem of accountability in public procurement is, in principle, no different from the one often appearing in private settings, where principals employ expert agents to perform certain profit-enhancing tasks. In both cases, principals confer a certain degree of discretion on agents who, in the absence of sharply defined or measurable goals, may exploit the granted discretion to make at least some decisions in their own interest, rather than in the interest of their principal. The difference between the case of public and private agents however lies in the availability and quality of potential control mechanisms (Bishop, 1990; Ogus, 1994). For example, when such problems arise in private market settings, such as in the case of managers and stockholders in corporations, they are mitigated by both legal restraints, e.g., fiduciary duties and contractual terms, and market constraints, i.e., the competition for corporate control. Where there is competition between rival management teams to manage the firm, the fear of hostile takeovers will control and minimize shirking by managers. This is because poor performance will reduce the value of the company shares, thereby making it more vulnerable to hostile takeovers, and the ensuing dismissal of undisciplined or slack managers (Bishop, 1990; Ogus, 1994).

On the other hand, in the case of public procurement exercising control over agents is much more complicated. Firstly, there is no homogenous group of principals to monitor the actions taken by the

agent. Instead there is a diverse collection of principals,[4] composed of interests represented by pressure groups influencing politicians and the general public. Secondly, in contrast to the case of competition for corporate control, there is no "market" for the control of contracting authorities. Thus, procurement agents do not really face the threat of dismissal, unless severe criminal or disciplinary misconduct is involved. Lastly, given that the objectives of government is not the maximization of profit, but rather the pursuit of the public interest,[5] it is almost impossible to measure agents' performance in monetary terms. Instead, control over procurement agents must rely on observations of input rather than output, and on prophylactic procedures instead of reward (Bishop, 1990).

Against this background, it is possible to identify two kinds of control mechanisms traditionally used by most national procurement systems to restrict the agency problem at the administrative level. The first consists of *ex ante* control measures, in the form of administrative procedures designed to limit the scope of discretion available to the agent whilst carrying out his tasks. The second is *ex post* oversight, which may take various forms including monitoring, imposing sanctions or using budgetary restrictions.

Ex Ante Control

As Bishop has observed (1990), the public control system is, and must be, more elaborate and more formal than that of a private corporation because the problem of agency control is much less tractable. Probably the most important method of control is through the definition of the obligations and duties of public agents *ex ante* by means of procedural regulations. Procedural regulations are the procedures agents are required to follow when exercising their delegated powers. In general these are designed to manage the collection and diffusion of information in a manner which is easily verified and enforced. Procedural requirements may be set out both in specific legislation[6] as well as in a "horizontal" fashion. An example of the latter is the Verwaltungsverfahrensgesetz in Germany, or the US Administrative Procedure Act (1946), both of which lay down general procedural requirements for public servants. In a public procurement context, procedural control usually takes the form of substantive obligations and formal rules, such as tendering procedures, publication duties, the definition in advance of the parameters upon which contract-award decisions are to be taken and

the application of principles such as transparency and equal treatment. This assists in reducing the possibilities for incompetent decisions, which otherwise may be due to either apathy or a deliberate abuse of discretion. In addition, procedural control helps to mitigate informational asymmetries between the principal and agent by requiring the latter to disclose information through periodical reports and fill-in forms.[7]

Obviously, the way in which procedural regulation is drafted has important consequences on the degree of autonomy and discretion public officials have in implementing specific policies. For example, legislation that is drafted in the form of *standards*, such as "the public official is instructed to act in the best interest of the government," leaves the question of how such objectives must be pursued under different circumstances open, and does not determine the level of effort the public official must take. Conversely, legislation may also be *rule-based* and be comprised of an advance determination regarding what kind of conduct is required in different situations, leaving only the determination of factual issues to the public official (Schäfer, 2003). The latter leaves little or no discretionary power with those who administer the legislation and thereby reduces the opportunities for shirking and corruption. In the context of public procurement, rule-based legislation also deprives procurement officials of the means necessary to achieve superior economic deals. This is due to the reduced scope for negotiations or the development of long-term relationships with suppliers. From this perspective, the tension between the goals of accountability in public procurement on the one hand, and securing economic efficiency on the other hand, is straightforward and any attempt to improve the achievement of one of these goals might come at the expense of the other.

Ex Post Oversight

There are several ways in which *ex post* oversight can be implemented to mitigate the principal-agent problem in the context of public procurement. First, procurement agents may be subject to some form of Ministerial control, which, in turn, is directly responsible to the electorate. A variety of methods are available to the Parliament for exercising oversight. Hearings, investigations, budget and sanctions are only a few examples of such means (Huber, 2000). For example, Ministers may demand formal or informal reports, or may

hold public hearings and investigations which facilitate public debate on certain issues and advance the disclosure of otherwise unavailable information. In certain situations, means may be exercised allowing agencies to be punished, or public officials removed from office. This may also affect the incentives faced by procurement agents already *ex ante*.

Nevertheless, Ministerial control is fraught with weaknesses. First, given the politicians' (legislators') limited time and expertise, they are most likely to respond only to the urgent concerns of affected citizens or interest groups, or "fire alarms," rather than conducting random checks on public officials' actions, or "policy patrols" (McCubbins & Schwartz, 1984). Secondly, the technical capability of Ministers to absorb, examine and make effective evaluations of information regarding the financial and professional decisions taken by the bureaucracy is doubtful. Thirdly, as public choice theory teaches us, politicians are usually subject to pressure stemming from lobbying by interest groups. Therefore the intervention of politicians in the bureaucratic decision-making process may actually create more distortions and open opportunities for political corruption. Lastly, the supervision of the bureaucracy by the political level involves excessive costs and may cause serious delays in the provision of public goods and services, which is after all, the main purpose of procurement regulation.

An alternative mechanism for exercising *ex post* oversight over procurement agents is through the appointment of superior authorities or commissioners with the task of supervising the decisions taken by contracting authorities. Such institutions are arguably less vulnerable to the influence of pressure groups and therefore the public choice problem is alleviated. Moreover, superior authorities are usually equipped with better qualified and more experienced personal and are therefore more capable of auditing the deployment of expenditures made by contracting authorities.[8] The reviews made by superior authorities may be either internal or external. In the case of the former, the reviewing authority belongs to the entity responsible for the procurement or the authority that supervises it.[9] In the case of the latter, there will be an independent entity, specifically created to review complaints about the procurement process such as a superior audit office, the national anti-trust authority or other independent supervisory bodies such as an ombudsman.[10]

In the case of internal authorities, the danger exists that rather than providing effective supervision, the superior authority will also find itself subject to the principal-agent problem. In such cases they may also be accused of bias favoring their administration or in more severe cases, of creating increased opportunities for upwards corruption. External supervision on the other hand, is less vulnerable to these problems and enjoys, at least at the outset, the perception by tenderers of being independent. Examples of external entities include the Danish Complaints Board for Public Procurement, which is authorized to process complaints about infringements of both community and national law; the Hungarian Public Procurement Committee, which is a body independent both from the government and from the Public Procurement Council; and outside the EU, the Government Accountability Office (GAO), which is responsible to evaluate federal programs, audit federal expenditures, and issue legal opinions in the US. In order to be effective, external supervision institutions must also be equipped with the ability to impose sanctions on contracting authorities found to be in breach of the procurement procedures. This is particularly important regarding the breach of integrity-related rules.

Last, *ex post* oversight may also take the form of judicial control. Judges enjoy an independence and autonomy which means they are relatively insulated from pressure arising from political and interest groups. On the face of it, this allows them a greater degree of independence and effectiveness in reviewing the activities of public procurement agents. Traditionally however, the role of the courts in this regard has been relatively limited compared to the other mechanisms discussed above. This has been attributed to three primary reasons. Firstly, the task of correcting bureaucracy decision-making process usually falls to the courts only after all other mechanisms have failed. Therefore judicial control has only a *residual* character (Bishop, 1990, p. 504). Secondly, one important characteristic of judicial review is that courts can intervene only when they are invited to do so by one or more individuals who think their rights have been injured or are likely to be injured as a result of an administrative act. Therefore from this point of view, judicial control is *reactive* rather than *proactive*. Thirdly, in some countries, most notably Common Law jurisdictions, but also to some extent in Continental Europe, for example in Germany, the government's contractual activities have been traditionally regarded as purely a

private matter outside the domain of public law and therefore not subject to administrative judicial review. Therefore courts are unlikely to be active unless some "element of public law" is related to the specific case (Arrowsmith, 1990). For these reasons, the contribution of courts in controlling the bureaucracy has traditionally been less important in comparison to the effects of the mechanisms already discussed above.

Nevertheless, in recent years a change in the courts' approach towards the bureaucracy has occurred, and there is a general consensus that judicial review has, and is likely to further increase (Baldwin & McCrudden, 1987; Woodhouse, 1997). The reasons for this change in approach exceed the scope of this enquiry. Therefore it is sufficient to mention only very briefly three factors which are relevant to public procurement and which are a direct result of the developments taken place on a regional level, more specifically, in the European Union. Firstly, the doctrine of direct effect, which confers on individuals the right to enforce legal norms of community law before national courts, has encouraged a more liberal approach on behalf of national courts and assisted in the implementation of community legal principles such as non-discrimination and equal treatment. Secondly, as influence from Western European civil law, the membership in the EU has had an impact in many member states on the development of principles underlying administrative law such as the principle of proportionality, equality, non-discrimination, protection of legitimate expectations, legal certainty and procedural propriety. These principles have become important legal grounds for reviewing administrative actions. Lastly, EU membership has resulted in domestic courts being increasingly interested in solutions being adopted in other jurisdictions, rather than purely concentrating on their own prior decisions. Thus the courts have become more willing to accept creative solutions. This has thereby allowed the shaping of new boundaries of review for administrative decisions.

The advantage of judicial review over other means of control in the public procurement context lies mainly in the fact that it relies on information provided by the supply side, i.e., suppliers and contractors. In most cases these are assumed to have both the expertise as well as the interest to oversee the decisions taken by bureaucrats. This is in contrast to uninformed politicians, and thereby the problem of asymmetric information between agents (procurement officials) and principals (elected representatives and the general

public) is alleviated. However the effectiveness of judicial oversight crucially depends on whether those firms interested in the outcome of the procurement procedures have relatively easy access to courts and whether they also find it beneficial to file lawsuits against public authorities in the case of infringement. If private firms are afraid to "bite the hand that feeds them" the effectiveness of judicial control over the bureaucracy will be diminished.

CONTROLLING THE AGENCY PROBLEM: THE INTERNATIONAL LEVEL

The analysis presented thus far has focused on the means used by most domestic procurement systems to ensure the accountability of their public procurement officials. However, in many cases domestic procurement regulations are subject to, and influenced by, international and regional procurement agreements, to which States are a signatory. The last two decades have witnessed the development of a record number of such agreements, which have been a direct result of the global movement towards international free trade. Although the extent and scope of the various agreements differ, they all have as their prime objective the opening up of domestic procurement markets to cross-border competition. The most notable examples of these regulatory systems are the international World Trade Organization (WTO) Government Procurement Agreement (GPA), which imposes on its member-countries common procurement rights and obligations, and the regional EC public procurement regime, which seeks to ensure economic integration in the field of public contracts among all member states of the European Community.

Notwithstanding the similarity in form and obligations between the international/regional agreements and domestic procurement systems, the substance and goals of regulation differs at the two levels (Arrowsmith, 2002; Arrowsmith, Lineralli & Wallace, 2000). Whereas national procurement systems aim at satisfying domestic needs and concerns, international/regional agreements seek to abolish discriminatory practices and, more often than not, forbid countries from using public procurement to promote domestic goals with the potential to restrain international trade. In the case of the European Union, the EC public procurement directives'[11] main (and only) goal is to protect the interests of traders established in one

member state who wish to offer goods or services to contracting authorities established in another member state.[12] Nevertheless, a closer examination of this regulatory regime reveals that the directives also have the potential to enforce accountability in member states whose procurement regulatory framework and enforcement agencies are underdeveloped or ineffective.[13] This is because the tools adopted at the community level in order to achieve the internal market policy coincide fairly closely with those often used by national systems in order to mitigate the principal-agent problem resulting from the delegation of discretionary power to procurement agents. Several key elements underlying the EC procurement directives (which are also common in most international/regional procurement systems) have the potential to enforce administrative and procedural control over the decisions taken by national procurement agents. These are, namely, transparency, the rules on technical specification, competitive bidding, and the application of objective criteria.

Transparency

In general, transparency means that the rules governing the public procurement procedures are clearly drafted and well defined, so that their implementation by procurement agents can be easily verified. From an international/regional perspective, transparency is considered fundamental for the elimination of distortions and discrimination on the grounds of nationality. When national policies, such as political, industrial or regional development policies, stand in conflict with the goal of competition and free trade, transparency has the capability to facilitate the detection of and, if counter measures are taken, the prevention of such policies from being exercised. The aim of these measures is to reduce the influence of discriminatory policies upon national purchasing decisions. In the European system for example, various mechanisms are used to ensure transparency. These mechanisms include, *inter alia*, requirements for community-wide publicity and advertisement of potential contracts and the criteria used for their award; the publication of the procedures chosen and their way of conduct;[14] and the publication of selection and award decisions and the reasons that led to them.[15]

Yet transparency has additional advantages. Besides providing for economic efficiency, by enhancing confidence and promoting competition amongst foreign and domestic suppliers, it also encompasses the principle of accountability. This is because

transparent procedures are the most effective deterrents against corruption and therefore they enable citizens and tenderers to scrutinize how the powers delegated to public procurement officials are being exercised. The obligations adopted at the community level, although aimed at ensuring that discrimination is not exercised against foreign suppliers, also have the effect of mitigating the agency problem. This is because they restrict the scope of discretion vested in the hands of public officials. Thus from an accountability perspective, a higher level of transparency reduces opportunities for the subjective and manipulated abuse of discretion by contracting authority's officials. It follows that at both the community and domestic levels, transparency serves as a control mechanism for preventing discrimination, regardless of the reasons initially motivating the adoption of such measures.

Technical Specifications

Another feature common to both international/regional and domestic procurement systems is the obligation to draw up technical specifications in a manner which reduces the opportunities for abuse by procurement agents. This can be achieved by making such specifications known in advance and by restricting the element of discretion entrusted in the hands of procurement agents when setting up the final description of the goods or services to be procured. From a European perspective, the aim is to prevent member states from referring to technical specifications that mention goods of a specific source already existing amongst domestic firms, or over-specifying such data in order to exclude foreign bidders from the competition. From a national perspective, it aims at ensuring that contracts are not "tailored" to a specific bidder who might maintain personal or business relations with the public official in charge of the process. Although the goals at community and national levels differ, the means used to ensure these goals are common, as both procurement systems seek to define such specifications in terms of performance rather than by reference to specific products.

Competition

There is a general obligation under both international/regional and most domestic systems to conduct a competitive tender procedure unless there are circumstances which justify recourse to exceptional procedures. The EC public procurement directives, for

example, seek to create competition to minimize the danger that the state will take into account non-market considerations and thereby discriminate against non-domestic bidders. In order to achieve this goal, the directives provide detailed rules (instead of standards) aimed at minimizing the discretion available to procurement agents and reduce the opportunities for discrimination on the grounds of nationality. From an accountability point of view, rule-based legislation provides more effective control over the bureaucracy. This also reduces the opportunities for abuse on grounds other than nationality, such as financial or personal interest, corruption or conflict of interest. In practice, the EC directives require the use of competitive bidding procedures aimed at selecting the winning bidder on the basis of stated criteria without the need for additional personal communication. In most cases, competitive bidding takes the form of the open or restricted procedures only. Under both of these procedures there is a general prohibition against discussions with tenderers, and bidders are not allowed to modify their bids after submission (Krüger, 1998). This reduces the chances of manipulations after bids have been submitted and ensures equality of treatment.

Competition however also has a price. As already mentioned above, this is because rigid competitive bidding procedures do not allow for the amount of flexibility available in real competitive markets. This, in turn, impedes the ability to yield better economic results, especially in cases of more complex contracts (Kelman, 1990). The EC directives, so critics argue, take a fairly stringent rule-based approach and deprive contracting authorities of the amount of flexibility required in order to achieve the best economic results (Arrowsmith, 2002). Whereas this critique may be justified from an economic efficiency perspective, it must also be balanced against the agency costs associated with a more lenient approach. Thus when the accountability of procurement agents represents an important concern, it may be claimed that a rule-based procurement system offers certain advantages otherwise unattainable under more lenient approaches.

Objective Criteria

Finally, international /regional procurement systems are also based on the application of objective criteria, which closely regulate the procedures following the receipt of tenders. This requires

contracting authorities to follow objectively, clearly and previously specified selection and award criteria for the evaluation of tenders. Together with the prohibition on discriminatory technical specifications, the application of objective criteria ensures that contracting authorities do not engage in concealed discrimination in favor of national industry and against foreign competition. The EC public procurement directives therefore prescribe specific suitability and award criteria including the grounds upon which tenderers may be excluded from tendering, the evidence required to show that they meet the criteria, and the elements according to which bids are evaluated. From an accountability perspective, the application of objective criteria has the effect of controlling the agency's decision-making process and preventing inappropriate distortions such as non-related considerations or personal interests from influencing the outcome of the tender. This, in turn, allows for the verification of the agent's conduct *ex post* and facilitates more effective control.

OTHER CONSIDERATIONS

Before concluding this analysis, it should be emphasized that despite the fact that domestic and arguably international/regional public procurement regulatory systems have the capacity to mitigate the agency problem, they are not by themselves sufficient to eliminate all forms of demand and supply-side corruption. In the case of the EU, the public procurement directives are applicable only to contracts of cross-border interest, thus contracts below the threshold value, as well as services concessions, fall outside the scope of the EC directives.[16] More importantly, even in the presence of effective control mechanisms, the public procurement process is likely to be affected by factors beyond the reach of the procurement agent himself. For example, corruption may be motivated by rent-seeking politicians subject to industrial pressure groups who try to influence award decisions. Corruption may originate from the supply-side, which faces valuable economic opportunities and may therefore seek to capture such gains by all means at his disposal. If public procurement agents are underpaid, bribes solicited by corrupted bidders may become a temptation too good to refuse. Moreover, corruption and lack of integrity may also be a matter of culture and accepted social norms, into which the procurement agent is forced to engage. In all these cases, it will become essential to use additional means in order to ensure that the procurement procedure is not affected. Such

means may include criminal and civil penalties, debarment and blacklisting of bidders accused of corruption, better training to procurement officials and higher salaries to public servants. From an international/regional perspective, additional efforts to curb corruption in public procurement may take the form of obligations assumed by signatory states to take measures in order to establish that it is a criminal offence under domestic law to offer, promise or give bribes to a foreign public official. The recent Organization for Economic Cooperation and Development's "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions," or the United Nations' "Convention against Corruption," are two examples of such attempts which acknowledge the importance of targeting supply-side corruption. Without the assistance of these types of measures, ensuring accountability and integrity in the procurement process by focusing only on the procurement agent will be insufficient to eliminate all kinds of integrity related problems in public procurement.

CONCLUSION

Making use of the principal-agent analysis in order to understand the problem of accountability in public procurement provides several interesting insights as to how opportunities for abuse by procurement agents can be reduced. The analysis presented in this chapter identified two main forms of control mechanisms employed by most domestic systems in order to ensure the accountability of their procurement officials. The first consists of *ex ante* measures, which will often take the form of administrative procedures integrated into the domestic public procurement regulation. The second takes the form of *ex post* oversight, which will be mostly external to the procurement regulation and consist of ministerial control, the existence of superior authorities or commissioners and judicial review. From an international/regional perspective, it has been argued that, although not directly aimed at such, these systems have the indirect effect of mitigating the principal-agent problem associated with the delegation of discretionary power to procurement agents. In the case of the European Union, the public procurement directives have subjected national procurement systems to wide-ranging transparency requirements and comprehensive sets of detailed rules. These rules, which are primarily aimed at ensuring cross-border competition, nevertheless have an incidental and

beneficial consequential impact on the goal of ensuring the integrity and accountability of public procurement agents. This is particularly the case in countries with less developed procurement regulation in place and ineffective enforcement agencies. This effect is mainly attributed to the detailed procedural nature of the directives and to the fact that they reduce the amount of discretion available to public servants when exercising their decision-making authority.

The reduction of discretion available to procurement agents and the consequential lessening of the agency problem may nevertheless have an incidental effect on economic efficiency. This is because a fairly stringent rule-based approach deprives procurement agents the amount of flexibility needed in order to achieve the best economic results, especially in cases where contracts are more complex. It therefore comes as no surprise to find out that countries endorsing a more commercial approach have often criticized the EC directives for interfering in a disproportionate manner with their national procurement policies. Whereas this argument is fully understandable in those member states with developed regulatory frameworks and reliable procurement agencies, the analysis above suggests that the EC directives have also the potential to strengthen accountability in member states whose procurement regulatory framework and enforcement agencies are less developed or ineffective. This consideration cannot be underestimated in light of the expansion of the European Union towards Central and Eastern Europe, where most commonly reported incidents of corruption usually concern the award of public procurement contracts (World Bank, 2004).

NOTES

1. This note is based on a chapter in Ohad Soudry (forthcoming). *The Regulation of Public Procurement in the EU: Legal and Economic Analysis* (Ph.D. Dissertation). University of Hamburg, Faculty of Law.
2. See also the excellent work by Trepte Peter (2004, Chapter 2).
3. Other aspects may include supply side integrity, for example fighting collusion in procurement auctions.
4. On multiple principals see McCubbins, Noll & Weingast (1987), and McCubbins, Noll & Weingast (1989).

5. Indeed, it would be naïve to claim that the governmental officials do not follow their own self-interest instead of the general public interest. While it is true that governments are subject to "market failures" such as state capture and agency problems, at this point these problems are laid to rest here.

6. Such legislation may take various forms, such as primary legislation, ministerial decrees, circulars or executive orders.

7. Procedural regulation has additional advantages. For example, it has the capability to produce policy decisions in accordance with the principal's preferences, even when the principal himself is uncertain of his preferred policy. This is done by assigning relative degrees of importance to specific ingredients of the policy in question and thereby channeling the agent's decisions towards the substantive outcomes that are most likely to serve the best interests of the principal. See McCubbins, Noll & Weingast (1987, p. 244).

8. See in this regard also the distinction made by Peter Trepte (2004, p. 52) with respect to the audit function and procurement function.

9. This is for instance the case in the Czech Republic, in which complaints are heard at first instance by the procuring authority. In the UK appeals related to the publication and conduct of the procurement exercise, the exclusion of a candidate or the award of the procurement contract, may be made to the head of the procuring authority. See OECD (2003).

10. Additional source of external control is exercised by the public media. However this type of control is external to the structure of the administration.

11. Directive 2004/18/EC on the coordination of procedures for the award of public supply contracts, public service contracts and public works contracts, OJ 2004 L134/114, and directive 2004/17/EC on the coordination of procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 L134/1.

12. See, *inter alia*, Case C-380/98, *University of Cambridge* [2000] ECR I-8035, para. 16.

13. This is probably more relevant in the case of the new member states as a recent World Bank report indicates that the most commonly reported incidents of corruption in Central and Eastern Europe concern the award of public procurement contracts. See World Bank (2004).

14. Article 35 of the public sector directive 2004/18/EC; Article 42 of the utilities directive 2004/17/EC.

15. Article 35 of the public sector directive 2004/18/EC; Article 43 of the utilities directive 2004/17/EC.

16. It should be noted however that contracts falling outside the scope of the public procurement directives may still be subject to the general principles of the EC Treaty, such as transparency, equal treatment and non-discrimination. See for example Case C-324/98, *Teleaustria Verlags Gesselschaft v. Post and Telekom Austria* ECR 2000, I-10745 and Case C-231/03 *Consorzio Aziende Metano (Coname) v. Comune di Cingia de'Botti*, ECR 2005 I-0000.

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