Some Economics of Joint Procurement

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Some economics of joint procurement

• Thanks for the invitation to such an interesting workshop

• Recent, 2014, EU Directives emphasise the possibility for joint procurement (JP)

• But, what is JP?

• Broadly speaking, JP takes place when a number of administrations purchase through the same organization.

• This is by no means a new feature in EU public procurement; yet the recent emphasis by the EU, particularly on spontaneous-voluntary JP, calls for further reflection
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• Indeed, as a first approximation JP may take place under two main, *top-down* and *bottom-up*, approaches.

• My main experience is with the *top-down* approach in *CONSIP*, the Italian Central Purchasing Body, set up by a Law in 1997.

• The EU interest in the issue is also manifested by the 2014 voluntary Agreement on JP for purchasing medicines against pandemics, to be discussed later in this session.

• This would be an example of the *bottom-up* approach, since countries would only adhere voluntarily
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• If JP can raise a number of economic issues when performed within countries, it does so even more when it is cross border, across countries

• In my presentation I’ll try to discuss some of the main points, without the ambition of being necessarily exhaustive
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• *Price* When JP is across countries, the economic component of the offer may be a single price.

• For example, if countries $A$, $B$ and $C$, with heterogeneous standards of living, need to buy a vaccine they may reach an agreement to set up a JP.

• If income per capita, cost of living, or other indicators of individual purchasing power are rather different across countries, should the same, single, unit price negotiated (tendered) for the three countries?

• Alternatively should price take into account the different living standards, and indeed differ across countries?
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• This is because a single, and the same, price could either be too low or too high, across countries

• A possible way out, for example, in a competition-negotiation where quality is given and suppliers compete on price only, could be as follows.

• To take account of the different standard of living across different areas, bidders would need to offer a standardised unit price $P_i, i = A, B, C$, to the JP, defined as $P_i = \frac{p_i}{S_i}$ where $S_i$ is some standard of living index, such as a consumption price index, per capita income, average price for medicines etc.
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• Upon having fixed $S_i$, suppliers would bid $P_i$ and the lowest offer would win

• Then, the winner commits to sell at unit price $p_i = P_i S_i$ in country $i = A, B, C$

• That is, when standards of living meaningfully differ the JP may consider setting up different prices in different countries, according to the standards of living, in case of a single contract.
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• *Skills* JP and, more in general, forms of centralisation ask for appropriate professional and ethical skills.

• The larger the contracts, the more complex and delicate procurements would be, the higher the needed expertise for successful procurement

• For this incentives such as career paths, rewards etc. may be contemplated

• Indeed, higher salaries spent for high profile professionals could be more than compensated by higher savings and quality standards
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• *Savings*  Economies of scale can exhibit in JP because of large contracts, which may lead to lower paid prices and higher savings

• However, savings would be an *unconditional* advantage if the quality promised by the contractor is delivered and, moreover, if large contracts would not create the conditions for dominant market positions.
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• *Lots* Though centralised as JP, procurement contracts could be split into different lots, for example one for each different country

• In this case care must be put to avoid coordinated market splitting across, as well as, within countries by the bidders.

• Access of SMEs could also be facilitated by division in lots

• Yet, setting up a JP may still be justified because concentration of competence could support those countries which are less endowed of.
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• *Quality* Related also to skills level and centralisation, a JP could guarantee to perform better quality control.

• It may also enhance quality, for example, in smaller countries as larger countries in the same JP may set higher standards.
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• Points discussed so far concern issues selected in my three pages, initial document, written for this conference

• Discussion with Prof. Tatrai raised few other issues, specifically related to the EU Directives, some of which I would like to mention, again mostly from an economic perspective
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• *Liability* This is an important point from both a legal and an economic point of view

• Consider again a JP formed by countries $A$, $B$, $C$, and suppose country $C$ breaches its own component of the contract (does not pay the entire amount, pays late etc.)

• Should responsibility be fully borne by $C$, jointly held by the three countries, and internally split according to some criterion, or only partly held also by $A$ and $B$?
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• For example, suppose in a JP with a single contractor $A$, $B$, $C$ spend, respectively, 100,000€, 50,000€, 25,000€, and $C$ refuses to pay 10,000€

• Should $C$ be the only country involved in a legal controversy or $A$ and $B$ should also be involved?

• If yes, should they be liable according to their weight in the overall contract? If yes then $A$ would bear the highest responsibility and, because of this, $B$ and $C$ may be tempted to undertake opportunistic behaviour?
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• **Approach** Voluntary vs enforced setting of JP procurements may affect the degree of acceptability by the relevant stakeholders and, relatedly, procurement success.

• In principle it seems that a *bottom-up* approach to JP, being voluntary, should be welcome and with a higher likelihood of success.

• Yet, a *top-down* approach may be system-wise more successful, perhaps despite a lower degree of acceptability by some of the stakeholders.
Thanks for your attention