

Public Procurement Legislation Essential for Improving Public Financial Management in India

Mukul G. Asher, Tarun Sharma and Shahana Sheikh

In response to input sought by the Ministry of Finance on the 2012 Public Procurement Bill.

EXECUTIVE SUMMARY

The new Indian government elected in May 2014 has commendably decided to seek suggestions to refine the Public Procurement Bill of 2012, which was introduced by the previous government. This signals the intention to secure the passage of the revised Bill during the remaining months of 2015. This Policy Brief focuses on three aspects relating to the Bill: its potential benefits, selected design features and implementation challenges.

The brief argues that potential benefits from well designed and implemented public procurement legislation include fiscal savings arising from annual procurement expenditure, generating much needed fiscal space, and fiscal flexibility to channel government expenditure into growth enhancing areas. One such area is increasing public investment with potential to crowd-in private investment. The procurement legislation could also assist in a shift towards rule-based institutional procurement process.

Estimation of potential fiscal savings from better procurement process is hampered with poor quality of data on total amount of procurement and its major components. This gap needs to be urgently addressed. A conservative but crude estimate of potential savings generated by the revised Bill ranges between 0.6 percent and 1.2 percent of GDP, depending on the extent of efficiency achieved. This compares well with the revenue deficit of 2.9 percent of GDP projected for 2014-15 by the Union budget.

Mukul Asher is Councillor at the Takshashila Institution and Professorial Fellow at the Lee Kuan Yew School of Public Policy, National University of Singapore. Tarun Sharma is an urban policy professional based in New Delhi and Shahana Sheikh is a Research Associate at the Centre for Policy Research, Delhi.

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The fiscal savings for India would be larger as if states also initiate similar procurement reforms. Together, states' expenditure about equals that of the Union government; and they will get increasingly larger share of Union resources in an unconstrained manner, and thus will need to shoulder greater responsibilities for their public finances and policy outcomes. The brief suggests considering entrusting this task to the NITI Aayog.

The brief makes several suggestions to improve the design features of the 2012 Bill:

- First, the brief suggests making the objective function of the bill less complex to ensure greater focus on procurement process efficiency and integrity, and to enhance accountability.
- Second, it suggests, the bill's scope be extended to include post contract procedures.
- Third, given judicial delays, and lack of economic literacy often displayed by the judiciary, procurement redressal committees should preferably be non-judicial, but need to be better specified to prevent undue discretion by procurement agencies.
- Fourth, whether the proposed Central Purchasing Office (CPO) will act as a nodal agency needs clarification. The nodal agency framework will need to be reconciled with decentralised procurement process suggested by the two recent committees to the Indian Railways.
- Fifth, the exclusion from procurement to be better specified. The scope for cost plus contracts needs to be reduced.
- Sixth, putting aside 1 to 2 percent of the procurement budget, and entrusting it to NITI Aayog to find solutions for urgent domestic public policy issues merits consideration.

The Brief discusses the following implementation challenges. First, the Bill needs to ensure that the new procurement regime is accompanied by streamlined data and information systems. Second, there are too many rules associated with the 2012 Bill, but the general principles on which the rules will be based remain unclear. This needs addressing. Third, procurement should be regarded as a task requiring professional skills and capacity building should be undertaken urgently to ensure appropriate skill sets and understanding business practices and logic.

Appropriately designed and implemented procurement legislation is a long overdue step towards better public financial management.

INTRODUCTION

Among the major continuing challenges in public financial management at all levels of government in India, has been obtaining commensurate outputs and societal outcomes from budgetary outlays. One of the major avenues which could contribute to meeting this challenge is a more efficient and effective public procurement system embedded in a modern legislation.

India's public sector agencies involved in various kinds of procurements realise that there are multiple financial irregularities in the procurement systems. Hence, in past few years, many of these agencies, both at the union and state levels, have been trying to establish efficient procurement systems to counter these irregularities. Government agencies have started conducting online price bidding or e-reverse auction or e-tendering as measures to effectively monitor the flow of funds and resource allocation. The new national government, formed in May 2014, has indicated its strong preference for instituting a transparent and well-functioning procurement system. Since May 2014, progress in this direction is evident in some sectors including procurement of food grains, and in purchases by the Indian Railways and Ministry of Defence.

The Finance Minister of India in his budget speech on 28th February 2015, recognised that sectoral progress while welcome is not sufficient. He expressed that "...malfeasance in public procurement can perhaps be contained by having a procurement law and an institutional structure consistent with the UNCITRAL [United Nations Commission on International Trade Law] model."¹ The new government also recognises that huge investments have been tied up due to the disputes in public contracts and hence, the Finance Minister proposed that this government will also introduce the Public Contracts (Resolution of Disputes) Bill for streamlining institutional arrangements that could resolve such disputes efficiently.

The Ministry of Finance, Government of India, introduced a Public Procurement Bill in the Lok Sabha in May 2012 under the previous government. The jurisdiction of the Bill covered any Ministry or Department of the Union Government of India, any Union Government's Public Sector Undertaking, or any company in which the government has a stake of more than 50 percent. Since the Bill was only introduced in the Lok Sabha, it lapsed with the fifteenth Lok Sabha.

Consistent with the priorities of the present government, the Ministry of Finance is seeking suggestions for refinements to the 2012 Bill from concerned stakeholders.² This signals the current government's intention to table and then to secure its passage in both houses of Parliament during 2015.

¹ <http://indiabudget.nic.in/ub2015-16/bs/bs.doc>

² http://finmin.nic.in/the_ministry/dept_expenditure/ppcell/PPDNotice180315.pdf

POTENTIAL BENEFITS

Lukas Vogel (2009) of the European Commission has argued that tangible macroeconomic benefits can result from procurement related savings in the form of increased GDP, employment, reduced budgetary pressures as well as enhanced fiscal space. Estimates of the value of public procurement in India in relation to the GDP vary widely from the Planning Commission's (2011) of 20 per cent, the Central Vigilance Commission's (2009) estimate of 30 per cent, and the Confederation of Indian Industry's (2012) estimate of 43 per cent.

The above suggests a vital gap in India's statistical system, as it remains unclear why these estimates vary so much – perhaps varied definitions of “public procurement” have been used by different institutions. Such a gap needs to be addressed for analysing the effectiveness of the procurement legislation.

A rather conservative, but crude, estimate of potential savings from introduction of the Union Government's procurement legislation may be obtained as follows. In 2013-14, in India, total outlay of the Union Government (including Public Sector enterprises) and State governments combined was INR 36.6 trillion, equivalent to 32.6 per cent of Gross Domestic Income (GDI) at market prices (2011-12 series).

The total expenditure of the Union Government was however INR 16.6 trillion, equivalent to 14.5 per cent of GDI. If personnel costs and other costs not part of procurement of goods, services, and physical assets are excluded, but relevant expenditure of public enterprises are added, then a crude estimate of procurement related expenditure would be around 12 per cent of GDI. Even a 5 per cent saving through better procurement process would yield 0.6 per cent of GDI in savings; and this figure would be 1.2 per cent of GDP if efficiency savings were 10 per cent. These compare well with revenue deficit of 2.9 per cent projected for 2014-15 by the Union budget, significantly improving fiscal consolidation efforts; while improving public expenditure management.

The above figures suggest that the share of States in combined expenditure is equal or slightly more than that of the Union government. With much larger devolution (and responsibilities) of Union government revenue to the States, including mining revenue, the potential benefits of modern procurement process can only be realised if individual States, with technical assistance from agencies such as NITI Aayog, also implement such a process³. This will generate more fiscal space which could be utilised in part to increase India's rather low Gross Fixed Capital Formation to GDP ratio of 29.7 percent in 2013-14 and help improve capital productivity. Another important benefit of formally legislating procurement process would be facilitating a shift towards rule-based institutional procurement process, mitigating politicisation of even routine decision making.

³ <http://pragati.nationalinterest.in/2015/03/the-evolving-dynamics-of-union-state-fiscal-relations/>

COMMENTS ON THE DESIGN FEATURES OF THE 2012 PUBLIC PROCUREMENT BILL

Let us first compare India's 2012 Bill with some of the established international best practices in the field of public procurement. These best practices are based on the UNCITRAL's Model Law 2011⁴, OECD's Principles for Integrity in Public Procurement 2009⁵ and the WTO's Government Procurement Agreement (GPA)⁶.

First, the Bill aims to "...regulate public procurement with the objectives of ensuring transparency, accountability and probity in the procurement process, fair and equitable treatment of bidders, promoting competition, enhancing efficiency and economy, maintaining integrity and public confidence in the public procurement process". This represents, perhaps, too complex an objective function of the Bill.

The UNCITRAL Model Law on Public Procurement and the WTO GPA primarily emphasise on competition and transparency issues, whereas the UN Convention against Corruption and the OECD's Principles for Integrity in Public Procurement are mostly focused on enhancing integrity in public procurement. This has also been noted by, CUTS (Consumer Unity & Trust Society) International⁷. Hence, the crucial question is whether the multiple objectives stated in the Bill can be operationalised in practice, with clarity on trade-offs involved among the objectives. Too many objectives often dilute accountability. Hence, refining the aims of the Bill towards a simpler set of objectives would be desirable. This would also assist in improving accountability of the procuring agencies; and facilitate the task of internal and external auditing agencies.

Second, the Bill defines the 'procurement process' as the "process of procurement extending from the issue of invitation to pre-qualify or to register or to bid, as the case may be, till the award of the procurement contract". However, this definition could be viewed as inadequate as OECD defines 'procurement process' as a cycle, having three phases of pre-tendering, tendering and post-tendering. The Bill's definition implies that post tendering steps such as contract management, order and payment, which occur after the award of a public procurement contract are excluded from the 'procurement process'.

Though the Bill contains sections on award of contract and terms and conditions that will bind the two entities, the sections simply say that contracts shall be in accordance with the provisions of the proposed legislation, the applicable rules and the conditions indicated in the bidding document. Such contracts that come as part of the bid documents, are often ad-hoc and inadequately defined.

⁴ <http://www.uncitral.org/pdf/english/texts/procurem/ml-procurement-2011/2011-Model-Law-on-Public-Procurement-e.pdf>

⁵ <http://www.oecd.org/gov/ethics/48994520.pdf>

⁶ https://www.wto.org/english/docs_e/legal_e/rev-gpr-94_01_e.pdf

⁷ http://www.cuts-citee.org/pdf/Government-Procurement-in-India_Domestic-Regulations-Trade-Prospects.pdf

Many a times, they are silent on any post contract management, monitoring mechanisms and quality checks. Post-contract opportunistic behaviour opportunities thus need to be addressed better in the Bill.

The relevant sections of the Bill are weighed in the favour of the procuring agencies through the terms and conditions set for payments, penalties, deliverables and others. As of now, a separate Bill seems to be the government's vision to resolve disputes in large public contracts. How the coordination among the modalities of two separate Bills will be achieved needs to be specified with greater clarity. The use of cost-plus contracts under the Bill also needs to be further limited.

Third, the Bill proposes to set up an independent grievance redressal mechanism by constituting independent procurement redressal committees. This is surely an improvement as compared to the present public procurement system wherein there is no such provision. However, these committees can only make recommendations but not enforce them as the procuring entity could well reject these recommendations. This is in contrast to the UNCITRAL Model Law which empowers the independent body for grievance redressal to take well specified actions ranging from prohibiting the procurement entity from acting, taking a decision or following a procedure which is not in compliance of the Law to ordering termination of the procurement proceedings. Further, while the Bill envisages these independent procurement redressal committees as non-judicial entities, unlike the WTO GPA which provides for judicial review in case the redressal agency is non-judicial, the Bill does not have any such provision (CUTS International has also emphasised this).

These procurement redressal committees could have powers to enforce their recommendations, but without recourse to the formal judicial system. This is especially in the light of judicial delays in India, and often lack of economic literacy exhibited in judicial proceedings and judgements. Hence, overall, the non-judicial mechanism in the procurement process has merit, but it needs to be better specified to prevent undue discretion by procurement agencies. For example, professional independent persons could be members of the redressal committees, with specified powers and term limits.

Fourth, the Bill does indicate the integrity code for the procuring entity or Central Purchase Organisation (CPO) and for the bidders. The even handedness is welcome. Greater clarity on whether the CPO will act as the nodal authority for public procurement in India is needed. The international practice is to designate such a nodal agency for procurement.

Here, the specific case of the Indian Railways is worth highlighting. Procurement by the Indian Railways is estimated to be about INR 1 trillion, of which the Railway Board accounts for half.

A report submitted by the E. Sreedharan Committee on the Indian Railways⁸ in mid March 2015 has argued that centralised procurement under the Railways Board has led to large scale rent seeking, hampering modernisation of the railways. It recommends giving more procurement powers to general managers and other operating heads. Furthermore, the interim report by the Committee for Mobilisation of Resources for Major Railway Projects and Restructuring of Railway Ministry and Railway Board⁹, submitted in end of March this year, has recommended delegation of enhanced powers related to tenders and procurements to Divisional Railway Managers (DRMs). When these steps concerning decentralisation of procurement decisions are instituted, they will need to be reconciled with a centralised nodal agency being suggested.

Fifth, the Bill is not applicable to procurements for less than INR 5 million, emergency procurements made for disaster management, and procurement for the purpose of national security. While exclusion of the latter two government activities are often mentioned in public procurement laws; however, the basis for discretion in case of a procurement of values lower than INR 5 million, which is a significant value, is not defined and the corresponding procedures of such procurements have not been specified. Further, the Bill also permits the procuring entity to limit competition in order to achieve other objectives, as well as exempt certain procurements from any of the provisions in the legislation such as the transparency requirements in “public interest”. However, as OECD states, limited competition should not lead to lower requirements in terms of transparency; it emphasises, “countries may use specific measures (e.g. reporting requirements, advance contract award notice, risk management techniques, etc.) to enhance transparency and integrity while counterbalancing the lack of competitiveness in the procedures.” These areas need to be refined to be consistent with realising genuine resource savings from the procurement process.

Ricardo Hausmann of Harvard University¹⁰ urged governments to set aside 5 per cent of their procurement budget to find solutions to urgent domestic public policy problems, but with potentially large global market. He argued that modern production involves not just conventional production-distribution-disposal costs, but also the cost of figuring out how to do them. This cost must primarily be met through government and not-for-profit sector budgets. In the Indian context, perhaps 1 to 2 per cent of the annual procurement budget could be specifically earmarked for exploring solution to areas such as education, health, water and waste management. Among the current agencies, entrusting this task to NITI Aayog merits serious consideration.

⁸ <http://timesofindia.indiatimes.com/india/Cartels-in-procurement-loot-railways-of-Rs-10000-crore-a-year-E-Sreedharan/articleshow/46776821.cms?>

⁹ http://www.indianrailways.gov.in/railwayboard/uploads/directorate/HLSRC/Interim_Report.pdf

¹⁰ <http://www.livemint.com/Opinion/1vXCT2p7AK43H55lluaJMP/The-procurement-gold-mine.html>

IMPLEMENTATION CHALLENGES

Once a revised Bill is passed by both the houses of the Parliament, several implementation challenges are likely to arise.

First, the data management and standards are a key issue. Both the bidder as well as the procuring entity has significant data and information needs to ensure transparency in public procurements. From bidder's side, it includes essential information required for preparation of proposals and execution, transparent disclosures relating to the procurement decisions made by the procuring entity and so on. From the procuring entity's perspective, this information is to ensure that the bidder (including the winner), reflects correct credentials and can ably undertake the contracted assignment and deliver the requisite deliverable in an efficient and timely manner.

Thus, it would be incumbent on any forthcoming legislation to ensure that the procurement system is accompanied by a streamlined data and information management system as well. This would be useful in maintaining key information related to companies, various documents submitted by them, information submitted by them against qualifying criteria, profiles of their staff and management, and their experience. It will also enable benchmarking prices to reference rates of manpower as well as out of pocket expenses, identifying appropriate timelines, milestones, penalties, and expert profiles.

Second, the rules associated with the 2012 Bill are numerous. Rules are the implementation framework for any Act. In the 2012 Bill, there are more than twenty references to these 'rules'. The Bill, however, does not lay down the general principles that the associated rules should be based on. For example, the Bill prefers open competitive bidding as a preferred method of procurement and any other way requires the procuring entity to record in writing the reasons for the same. It needs to be ensured that the detailed rules and regulations are elaborate, clear and definite in all other methods of procurements as they might be needed and more convenient in particular circumstances. While framing the rules and operationalising the Act, it will also need to be ensured that all the existing Rules, Acts etc. are made consistent with the Bill. In this context, associated issues such as e-procurement, preferential procurement, procurement by Public Sector Undertakings (PSUs), and green procurement need to be looked at in detail.

The third implementation challenge concerns the skills-set of the officials that would be at the interface of the procurement. Presently, the in-house staff of many government departments is not fully conversant with the procurement management, norms, rules and regulations; legal ramifications; contract management issues and so on. Issues such as contract variations, taxation issues, performance and quality management, and exit clauses are not reflected well in the terms of references.

Bid process management and contract management require tact and commercially realistic responses, which are also consistent with broader public interest. Thus, along with a new procurement regulation regime, the capacity building of those involved in government procurement needs to be a parallel exercise.

It would be useful to regard the procurement function as involving relevant professional qualifications and skills, and to staff the agencies accordingly. An explicit commitment in the revised Bill in this direction deserves inclusion.

The new government's initiative to formally legislate Union government's procurement process should be welcomed by all those recognising the urgency of improving India's public financial management. It is hoped that both design and implantation issues raised in this note will be helpful in revising the 2012 Bill to achieve better value-for-money from the public procurement process.