1. Introduction

PUBLIC PROCUREMENT WITHIN EUROPEAN UNION LAW

The creation and proper functioning of the common market rest in the heart of European Union law. The Treaties establishing the European Union have envisaged a system of legal, economic and political integration which is to be achieved through the progressive convergence of the economic policies of member states.[1]

The concept of the common market embraces the legal and economic dynamics of the European integration process, with clear political ambitions for its accomplishment, and presents the characteristics of a genuine integrated market. Such a market is a place where unobstructed mobility of factors of production[2] is guaranteed and where a regime of effective and undistorted competition regulates its operation. These characteristics reflect the four fundamental freedoms of a customs union (free movement of goods, persons, capital and services)[3] and, to the extent that the customs union tends to become an economic and monetary one,[4] on the adoption of a common economic policy and the introduction of a single currency. The adherence by member states to the above-mentioned fundamental principles of European economic integration will result in the removal of any restrictions or obstacles to inter-state trade. The level of success of economic integration in Europe will determine the level of success of political integration among member states, which is the ultimate objective stipulated in the Treaties.

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1 See Articles 2 and 3 of the Treaty of Rome (EC).

2 See Articles 48 and 67 EC respectively.

3 The European Court of Justice has recognised a fifth freedom, the free movement of payments, which is closely related to the freedom of movement of capital, see cases 286/82 & 26/83, *Luisi & Carbone v. Ministero del Tesoro*, [1984] ECR 377, 308/86 *Ministère Public v. Lambert*, [1988] ECR 478. The Treaty of Rome provides also for the accomplishment of this freedom in Articles 67(2) and 106. The free movement of payments, a complementary principle of the free mobility of capital as a production factor, plays an extremely important role in the process of integration of public markets, and in particular in financing public projects either through indirect or direct investment.

4 See Article 102a EC

Two strategic plans have facilitated the economic integration of the member states. These plans were enacted by European institutions and have been subsequently transposed into national laws and policies by member states. The first plan included a series of actions and measures aiming at the abolition of all tariff and non-tariff barriers to intra-community trade. The second plan has focused on the establishment of an effective, workable and undistorted regime of competition within the common market, in order to prevent potential abuse of market dominance and market segmentation, factors which could have serious economic implications in its functioning. The first plan, the abolition of all tariff and non-tariff barriers to intra-community trade, reveals a static effect which aimed at eliminating all administrative and legal obstacles to free trade and had as its focal point member states and their national administrations. The second plan, the establishment of an effective, workable and undistorted regime of competition within the common market, has been implemented at industry level and has an on-going and dynamic effect.

All tariff barriers appear to have been abolished by the end of the first transitional period,[5] so customs duties, quotas and other forms of quantitative restrictions could no longer hinder the free flow of trade amongst member states. Non-tariff barriers, however, have proved more difficult to eliminate, as they involve long-established market practices and patterns that could not change overnight. Non-tariff protection represents a disguised form of discrimination and can occur through a wide spectrum of administrative or legislative frameworks relating to public monopolies, fiscal factors such as indirect taxation, state aid practices and subsidies, technical standards and last but not least public procurement. Non-tariff barriers are by no means confined to the European integration process. The existence of non-tariff barriers is a common phenomenon in world markets and their elimination is the main objective of regulatory instruments of international trade. It has been maintained that non-tariff barriers could seriously distort the operation of the common market and its fundamental freedoms and derail the process of European integration.

The European Commission's White Paper for the Completion of the Internal Market[6] identified existing non-tariff protection and provided the framework for specific legislative measures[7] in order to address the issue at

5 The first transitional period covers the time period from the establishment of the European Communities until 31/12/1969. See Article 8(7) EC.

6 See European Commission, *White Paper for the Completion of the Internal Market*, (COM) 85 310 final, 1985.

7 The completion of the internal market required the adoption at Community level and the implementation at national level of some 300 Directives on the subjects

national level. The enactment of a set of Directives was deemed necessary for the completion of the internal market by the end of 1992, and the timetable was set out in the Single European Act, which in fact amended the Treaty of Rome by introducing *inter alia* the concept of the internal market. The internal market, in quantifiable terms, could be considered as something less than the common market but, perhaps, the first and most important part of the latter, as it '. . . would provide the economic context for the regeneration of the European industry in both goods and services and it would give a permanent boost to the prosperity of the people of Europe and indeed the world as a whole'.[8]

The internal market, as an economic concept, could be described as an area without internal frontiers, where the free circulation of goods and the unhindered provision of services, in conjunction with the unobstructed mobility of factors of production, are assured. The concept of the internal market is a reinforcement of the principle of the customs union as the foundation stone of the common market. The internal market embraces, obviously, less than the common market to the extent that the economic and monetary integration elements are missing. The Single European Act (SEA), as a legal instrument amending the Treaty of Rome, reveals strong public law characteristics, since the regulatory features of its provisions promote the importance of certain areas that had been previously overlooked. As a result, there has been both centralised and decentralised regulatory control by European institutions and member states over environmental policy, industrial policy, regional policy and the regulation of public procurement. The above areas represented the priority objectives in the process of completing the internal market. Public procurement was specifically identified as a significant non-tariff barrier and a detailed plan was devised to address the issue. The European Commission based its action on two notable studies.[9] Those studies provided empirical proof of the distorted market conditions in the public sector and highlighted the benefits of the regulation of public procurement.

The regulation of public procurement in the European Union has been significantly influenced by the internal market project. The White Paper for

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specified in the Commission's White Paper. See also the *Third Report of the Commission to the European Parliament on the Implementation of the White Paper*, (COM) 88 134 final.

[8] See Lord Cockfield's quotation in the Cecchini Report, *1992: The European Challenge, The Benefits of a Single Market*, Wildwood House, 1988.

[9] See Commission of the European Communities, *The Cost of Non-Europe, Basic Findings, Vol. 5, Part. A: The Cost of Non-Europe in Public Sector Procurement*, Official Publications of the European Communities, Luxembourg, 1988. Also the Cecchini Report, *1992*, op cit.

the Completion of the Internal Market[10] and the Single European Act represent the conceptual foundations for the regulation of public markets in the member states. The identification of public procurement as a significant non-tariff barrier has offered ample evidence on the economic importance of its regulation.[11] Savings and price convergence appeared as the main arguments for liberalising the trade patterns of the demand (public and utilities sectors) and supply (industry) sides of the public procurement equation.[12] The regulation of public procurement exposes an economic and a legal approach to the integration of public markets in the European Union. On the one hand, the economic approach to the regulation of public procurement aims at creating an integral public market across the European Union. Through the principles of transparency, non-discrimination and objectivity in the award of public contracts, it is envisaged that the public procurement regulatory system will bring about competitiveness in the relevant product and geographical markets, increase import penetration of products and services destined for the public sector, enhance the tradability of public contracts across the common market, result in significant price convergence and finally be the catalyst for the needed rationalisation and industrial restructuring of the European industrial base.[13]

The legal approach to the regulation of public procurement, on the other hand, reflects a medium which facilitates the functions of the common market. In parallel with the economic arguments, legal arguments have emerged supporting the regulation of public procurement as a necessary ingredient of the fundamental principles of the Treaties, such as the free movement of goods and services, the right of establishment and the prohibition of discrimination on nationality grounds.[14] The legal significance of the regulation of public procurement in the common market has been well documented through the Court's jurisprudence. The liberalisation of public procurement indicates the wish of European institutions to eliminate preferential and discriminatory purchasing patterns by the public sector and create seamless intra-community trade patterns between the public and private sectors. Procurement by member

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10 See European Commission, *White Paper for the Completion of the Internal Market*, op cit.

11 See Commission of the European Communities, *The Cost of Non-Europe*, op cit. Also the Cecchini Report, *1992* op cit.

12 The European Commission has claimed that the regulation of public procurement could bring substantial savings of ECU 20 bn or 0.5% of GDP to the (European) public sector. See European Communities, *The Cost of Non-Europe*, op cit.

13 See Commission of the European Communities, *Statistical Performance for Keeping Watch over Public Procurement*, 1992. Also the *Cost of Non-Europe*, op cit.

14 See Bovis, 'Recent case law relating to public procurement: A beacon for the integration of public markets', *Common Market Law Review*, 39 (2002).

states and their contracting authorities is often susceptible to a rationale and a policy that tend to favour indigenous undertakings and *national champions*[15] at the expense of more efficient competitors (domestic or Community-wide). As the relevant markets (product and geographical) have been sheltered from competition, distorted patterns emerge in the trade of goods, works and services destined for the public sector. These trade patterns represent a serious impediment in the functioning of the common market and inhibit the fulfilment of the principles enshrined in the Treaties.[16]

Legislation, policy guidelines and jurisprudence have all played their role in determining the need for integrated public markets in the European Union, where sufficient levels of competition influence the most optimal patterns of resource allocation for supplying the public sector as well as the public utilities with goods, works and services. Public procurement has now been identified as a key feature in the vision of the European Union in becoming the most competitive economy in the world by 2010.[17]

THE THRUST OF PUBLIC PROCUREMENT REGULATION

Whereas the regulatory weaponry for private markets is dominated by anti-trust law and policy, public markets are fora where the structural and behavioural remedial tools of competition law emerge as rather inappropriate instruments of a regulatory framework. The applicability of competition law to public markets is limited, mainly due to the fact that anti-trust often clashes with the monopolistic structures which exist in public markets. State participation in market activities is regularly assisted through exclusive exploitation of a product or a service within a geographical market. The market activities of a public entity are protected from competition by virtue of laws on trading and production or by virtue of delegated monopolies. Another reason for the

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15 The term implies a firm with more than a third of its turnover made in its own country which has enjoyed formal or informal government protection. The term has been defined by Abravanel and Ernst, 'Alliance and acquisition strategies for European national champions', *The McKinsey Quarterly* (2) (1992), 45–62.

16 See Nicolaides (ed), *Industrial Policy in the European Community: A Necessary Response to Economic Integration*, Martinus Nijhoff, 1993.

17 See Communication from the European Commission to the Council, the European Parliament, the Economic and Social Committee, and the Committee of the Regions, 'Working together to maintain momentum', 2001 Review of the Internal Market Strategy, Brussels, 11 April 2001, COM (2001) 198 final. Also European Commission, Commission Communication, Public Procurement in the European Union, Brussels, 11 March 1998, COM (98) 143.

limited applicability of anti-trust law and policy in public markets is the fact that conceptual differences appear between the two categories of markets – private and public – in the eyes of anti-trust, which could be attributed to their different nature. In private markets, anti-trust law and policy seek to punish cartels and abusive dominance of undertakings. The focus of the remedial instruments is the supply side, which is conceived as the commanding part in the supply/demand equation due to the fact that it instigates and controls demand for a product. In private markets, the demand side of the equation (consumers in general) is susceptible to exploitation and the market equilibria are prone to distortion as a result of the collusive behaviour of undertakings or an abusive monopoly position. On the other hand, the structure of public markets reveals a different picture. In the supply/demand equation, the dominant part appears to be the demand side (the state and its organs as purchasers), which stimulates demand through purchasing, whereas the supply side (the industry) fights for access to the relevant markets. Although this is normally the case, one should not exclude the possibility of market oligopolisation and the potential manipulation of the demand side.[18] These advanced market structures may occur more often in the future, as a result of the well-established trends in industrial concentration.

Another argument which has relevance to the different regulatory approach to public and private markets reflects the methods of possible market segmentation and abuse. It is maintained that the segmentation of private markets appears different than the partitioning of public ones. In private markets, market segmentation occurs as a result of cartels and collusive behaviour, which would lead to abuse of dominance, with a view to driving competitors out of the relevant market, increasing market shares and ultimately increasing profits. Private markets can be segmented both geographically and by reference to product or service, whereas public ones can only be geographically segmented. This assumption leads to the argument that the partition of public markets would probably be the result of concerted practices attributed to the demand side. As such concerted practices focus on the origin of a product or a service or the nationality of a contractor, the only way to effectively partition the relevant market would be by reference to its geographical remit. In contrast, as far as private markets are concerned, the segmentation of the relevant market (either product or geographical) can only be attributed to the supply side. The argument goes further to reveal the fact that the balance of power between the supply and the demand sides is reversed in public markets. In the latter, it is the demand side that has the dominant role in the equation by

[18] See Konstadacopoulos, 'The linked oligopoly concept in the Single European Market', *Public Procurement Law Review*, 4 (1995), 213.

dictating terms and conditions in purchases, initiation of transactions, as well as in influencing production trends.[19]

In public markets, concerted practices of the demand side (for example, excluding foreign competition, application of buy-national policies, and application of national standards policies) represent geographical market segmentation, as they result in the division of the European public markets into different national public markets. It could also be maintained that public markets are subject to protection – rather than restriction – from competition, to the extent that the latter are quasi-monopolistic and monopsonistic in their structure. Indeed, the state and its organs, as contractors, possess a monopoly position in the sense that no one competes against them in their market activities.[20] Even in cases of privatisation, the monopoly position is shifted from the public to private hands. The situation is different in cases of an open privatised regime pursuing an operation in the public interest. In that case, it would be more appropriate to refer to oligopolistic competition in the relevant market. Also in privatised regimes, interchangeability of supply is very limited, to the extent that monopoly position characteristics survive the transfer of ownership from public to private hands. The state and its organs also possess a monopsony position, as firms engaged in transactions with them have no alternatives to pursue business. Access barriers to geographical public markets are erected by states as a result of exercising their discretion to conclude contracts with national undertakings. This type of activity constitutes the partition of public markets in the European Union, whereas undertakings operating in private markets must enter into a restrictive agreement between themselves in order to split up the relevant markets. Due to their different integral nature, private and public markets require different control. The control in both cases has a strong public law character, but while anti-trust regulates private markets, it appears rather inappropriate for public ones. Anti-trust law and policy is a set of rules of a negative nature; undertakings must *restrain* their activities to an acceptable range pre-determined in due course by the competent authorities. On the other hand, public markets require a set of rules that have a positive character. It should be recalled that the integration of public markets is based on the abolition of barriers and obstacles to national markets; it then follows that the type of competition envisaged for their regulation is mainly *market access competition.* Above all, this indicates that price competition is expected to emerge in European public markets only after their integration.

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[19] See Bovis, 'The regulation of public procurement as an element in the evolution of European economic law', *European Law Journal* (Spring 1998).

[20] See Swann, *The Retreat of the State*, Harvester-Wheatsheaf, 1988, chapters 1–2.

It appears, however, that in both private and public markets, two elements have relevance when attempting their regulation. The first element is the *price differentiation* of similar products; the second element is *access* to the relevant markets. As the European integration is an economic process which aims at dismantling barriers to trade and approximating national economies, the need to create acceptable levels of competition in both public and private markets becomes more demanding. In fact, a regime of genuine competition in public markets would benefit the public interest as it would lower the price of goods and services for the public, as well as achieving substantial savings for the public purse.

The evolution of public procurement regulation in the European Union points towards a strategy for eliminating discriminatory public procurement amongst member states that have posed significant obstacles to the fundamental principles of free movement of goods, the right of establishment and the freedom to provide services. That strategy has been based on two principal assumptions: the first assumption acknowledged the fact that in order to eliminate preferential and discriminatory purchasing practices in European public markets, a great deal of *transparency* and *openness* was needed; the second assumption rested on the premise that the only way to regulate public procurement in the member states in an effective manner was through the process of *harmonisation* of existing laws and administrative practices which had been in operation, and not through a *uniform* regulatory pattern which would replace all existing laws and administrative practices throughout the Community. The latter assumption indirectly recognised the need for a decentralised system of regulation for public procurement in the Community, well ahead of the pronouncement of the principle of *subsidiarity* which was introduced in the European law jargon some years later by virtue of the Maastricht Treaty on European Union.

Since harmonisation was adopted as the most appropriate method of regulation of public procurement in the common market, and the decentralised character of the regime was reinforced through legislation, the onus then was shifted to the national administrations of the member states, which had to implement the Community principles in domestic law and give a certain degree of clarity and legitimate expectation to interested parties. Occasionally, the European Commission is criticised for not reserving for itself or other Community institutions central powers, other than those already available and at its disposal as the guardian of the Treaty, in relation to the enforcement of and compliance with public procurement rules. Critics often refer to the applicability of competition law and policy of the European Union and the regime which legally implements it through specific Regulations. However, although in principle competition law of the European Union may apply to the

awarding of public contracts,[21] the *effectiveness* and *efficiency* of a regulatory regime in the public markets through basic anti-trust remedies remains a challenge for the law and for policy makers. Application of a rigid regime in a uniform way across the common market would not take into account national particularities in public procurement and a highest common denominator would probably eliminate any elements of *flexibility* in the system. Public procurement, as the *nexus* of transactions in the supply chain of the public sector, does not differ in principle from the management of purchasing practices in the private sector, which remains unregulated.

The legal instruments chosen by European institutions to achieve the objective of flexibility are Directives. Public markets and their regulation are dominated by different legal regimes and legal approaches that diverge to a considerable extent from each other. Directives, as flexible legal instruments leaving a great deal of discretion in the hands of member states with respect to the forms and methods of their implementation, can harmonise public markets, taking into account existing divergences in domestic legal systems. The appropriateness of Directives to achieve the desired degree of competition in public markets and establish a regime where optimal resource allocation benefits the public interest is unquestionable. The nature and character of Directives, as '*framework*' legal instruments, aim at harmonising existing legal systems, bringing them into conformity with envisaged Community objectives. Directives attempt to approximate different national laws and achieve a similar legal regime throughout the common market, based on the lowest common denominator amongst the systems of the member states. Divergences will inevitably remain, as the European Union lacks the powers to abolish existing domestic legal regimes and impose *ab initio* a different one.[22] Nevertheless, it

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[21] See case *Cooperative Vereniging 'Suiker Unie' UA v. Commission*, [1975] ECR 1663, in which the European Court of Justice recognised the adverse effects of concerted practices in tendering procedures on competition in the common market. This case appears to have opened the way for the application of competition law to public procurement in the Community. The applicability of Competition Law provisions of the Treaty (Articles 81, 82 EC) in controlling collusive tendering and anti-competitive behaviour of suppliers was also the subject of Commission Decision 92/204, OJ 1992 L 92/1. It could be argued that competition law and policy apply equally to private as well as public markets, but the explicit provisions of the Directives on consortia participation in tendering procedures might limit the scope of Articles 81 EC and 82 EC on public procurement.

[22] For the constitutional aspects of the application of a Regulation in domestic legal orders, see the reservations of the French Government after the adoption of the SEA and in particular Article 100A EC, which constitutes the legal basis of all Public Procurement Directives after 1986 in Kapteyn and Verloren van Themaat, *Introduction to the Law of the European Communities*, 2nd edn, Kluwer-Deventer, 1989, pp. 470–79.

should be pointed out that Regulations aim at unification of the regimes governing the member states' legal orders and have been extensively used in the anti-trust field. It could be further argued that Regulations reveal all the characteristics of instruments of public law, in particular to the extent that they are directly applicable and produce vertical and horizontal direct effectiveness. Apart from the creation of a uniform system common to the internal legal orders of the member states, other notable advantages of having recourse to Regulations instead of Directives would have been the fact that individuals could directly rely on their provisions not only against the state but also against other individuals before domestic courts.

Directives, on the other hand, appear to have strong characteristics as instruments of public law, inasmuch as they constitute the legal framework within which the state must enact rules that regulate the relevant sector. Directives, unlike Regulations, lay down duties and obligations addressed only to member states. Regulations, in addition, introduce rights of individuals to be respected by member states and also other individuals. Directives resemble circulars at domestic administrative level, to the extent that the latter provide the framework for action by central government towards the competent decentralised authority. The difference is that Directives are binding legal instruments and may be relied upon before national courts by individuals under certain circumstances restrictively interpreted by the European Court of Justice (the case of direct effect), whereas administrative circulars produce no binding effects. Directives, as Community legal instruments, were thought to be the most appropriate method to regulate public markets in the European Union. As mentioned above, fundamental differences in existing national legal systems dictated the continuation of domestic public market regimes, but the main concern was their enforcement at national level. In fact, it was the range of procedural and substantive sensibilities and peculiarities found in the judicial infrastructure of the member states, especially the system through which judicial review of public procurement is channelled, that prevented legal unification at Community level by means of Regulations.

Treaty provisions on non-discrimination, on the prohibition of barriers to intra-community trade, on the freedom to provide services and on the right of establishment, on public undertakings and undertakings to which member states grant special or exclusive rights and on state monopolies providing services of general economic interest, although capable of embracing the legal relations arising from public procurement in the common market and regulating intra-community trade of public contracts according to the principles stipulated in the Treaties, seemed insufficient on their own to eliminate the protection afforded to domestic undertakings by preferential public procurement. The diversity of legal systems within the member states of the European Union and the differences in existing domestic public procurement rules

would have rendered the regulation of public markets ineffective, if recourse was sought solely to primary Community legislation. The negative character of the primary Community provisions which apply to public procurement, to the extent that they provide a legal framework which prohibits any obstructions, distortions and hindrances to intra-community trade and the relevant fundamental principles, could be seen as the main reason for the need by European institutions to intervene and introduce a set of rules which, although based upon the primary Community rules above, have a positive character in the sense that they allow a margin of discretion in their implementation. Owing to the decentralised nature of any regulatory form of public procurement in the common market, the normative character of the primary Community rules was diluted in favour of a process of harmonisation of existing laws and practices in the member states.

THE NOTION OF PUBLIC MARKETS

The main reason for regulating public sector and utilities procurement is to bring their respective markets parallel to the operation of private markets. European policy makers have recognised the distinctive character of *public markets* and focused on establishing conditions similar to those that control the operation of private markets. The public markets reflect an economic equation where the demand side is represented by the public sector at large and the utilities, whereas the supply side covers industry.

The state and its organs enter the market place in pursuit of the public interest.[23] However, the activities of the state and its organs do not display the commercial characteristics of private entrepreneurship, as the aim of the public sector is not the maximisation of profits but the observance of public interest.[24] This fundamental difference emerges as the basis for the creation of *public markets* where public interest substitutes for profit maximisation.[25]

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[23] See Valadou, 'La notion de pouvoir adjudicateur en matière de marchés de travaux', *Semaine Juridique* (1991), ed. E, no. 3; Bovis, 'La notion et les attributions d'organisme de droit public comme pouvoirs adjudicateurs dans le régime des marchés publics', *Contrats Publics* (September 2003).

[24] Flamme and Flamme, 'Enfin l' Europe des Marchés Publics', *Actualité Juridique – Droit Administratif* (1989).

[25] On the issue of public interest and its relation to profit, see cases C-223/99, *Agora Srl v. Ente Autonomo Fiera Internazionale di Milano* and C-260/99 *Excelsior Snc di Pedrotti Runa & C v. Ente Autonomo Fiera Internazionale di Milano*, [2001] ECR 3605; C-360/96, *Gemeente Arnhem Gemeente Rheden v. BFI Holding BV*, [1998] ECR 6821; C-44/96, *Mannesmann Anlangenbau Austria AG et al. v. Strohal Rotationsdurck GesmbH*, [1998] ECR 73. The existence of profitability deprives the

However, further variances distinguish private from public markets. These focus on structural elements of the market place, competitiveness, demand conditions, supply conditions, the production process, and finally pricing and risk. They also provide an indication of the different methods and approaches employed in their regulation.[26]

Private markets are generally structured as a result of competitive pressures originating in the interaction between buyers and supplier and their configuration can vary from monopoly or oligopoly conditions to models representing perfect competition. Demand arises from heterogeneous buyers with a variety of specific needs, is based on expectations and is multiple for each product. Supply, on the other hand, is offered through various product ranges, where products are standardised using known technology, but constantly improved through research and development processes. The production process is based on mass-production patterns and the product range represents a large choice including substitutes, whereas the critical production factor is cost level. The development cycle appears to be short to medium term and finally, the technology of products destined for private markets is evolutionary. Purchases are made when an acceptable balance between price and quality is achieved. Purchase orders are in bulk and at limited intervals. Pricing policy in private markets is determined by competitive forces and the purchasing decision is focused on the price–quality relation, where the risk factor is highly relevant.

On the other hand, public markets tend to be structured and to function in a different way. The market structure often reveals monopsony characteristics.[27] In terms of its origins, demand in public markets is institutionalised and operates mainly under budgetary constraints rather than being subject to the price mechanism. It is also based on fulfilment of tasks (pursuit of public interest) and it is single for many products. Supply also has limited origins, in terms of the establishment of close ties between the public sector and the industries supplying it, and there is often a limited product range. Products are rarely innovative and technologically advanced and pricing is determined through tendering and negotiations. The purchasing decision is primarily based upon the life-time cycle, reliability, price and political considerations. Purchasing patterns follow tendering and negotiations and often purchases are dictated by policy rather than price/quality considerations.

The intellectual support of public procurement regulation in the European Union draws inferences from economic theories. Although the regulation of

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relevant market of public interest functions, since it cultivates competition and as a result the substitutability of supply denotes that the market is a private market.

[26] See Bovis, *The Liberalisation of Public Procurement in the European Union and its Effects on the Common Market,* Ashgate, 1998, chapter 1.

[27] Monopsony is the reverse of monopoly power. The state and its organs often appear as the sole outlet for an industry's output.

public procurement aims primarily at the purchasing patterns on the demand side, it is envisaged that the integration of public markets through enhanced competition could bring about beneficial effects for the supply side. These effects focus on the optimal allocation of resources within European industries, the rationalisation of production and supply, the promotion of mergers and acquisitions and the creation of globally competitive industries. Public procurement has cyclical dynamics. It purports to change both behavioural and structural perceptions and applies its effects to both the demand and supply sides.

The integration of public markets in the European Union is achieved solely by reference to the regulation of the purchasing behaviour of the demand side (the contracting authorities). The behaviour of the supply side is not the subject of public procurement legislation, although its regulation would arguably be of equal importance to the integration of public markets in the European Union. The supply side in the public procurement equation is subject to the competition law and policy of the European Union, although there is no integral mechanism in the public procurement legislation which is capable of introducing anti-trust rules to the supply side. *Stricto sensu*, anti-competitive behaviour of undertakings or collusive tendering do not appear as reasons for disqualification from the selection and award procedures of public contracts.

European institutions have assumed that encouraging the public and utilities sectors in the European Union to adopt purchasing behaviour which is homogeneous and based on the principles of openness, transparency and non-discrimination will achieve efficiency gains and public sector savings and stimulate industrial restructuring on the supply side.

The European Commission has claimed that the regulation of public procurement throughout the European Union and the resulting elimination of non-tariff barriers arising from discriminatory and preferential purchasing patterns of member sates could bring about substantial savings estimated around 0.5% of the gross domestic product of the European Union. Combating discrimination on grounds of nationality in the award of public procurement contracts and eliminating domestic preferential purchasing schemes could result in efficiency gains at European and national levels through the emergence of three major effects which would primarily influence the supply side. These include a *trade effect*, a *competition effect* and a *restructuring effect*.

The trade effect represents the actual and potential savings that the public sector would be able to achieve through lower cost purchasing. The trade effect is a result of the principle of transparency in public markets (compulsory advertisement of public contracts above certain thresholds). However, the principle of transparency and the associated trade effect in public markets do not in themselves guarantee the establishment of competitive conditions in the

relevant markets, as market access – a structural element in the process of integration of public markets in Europe – could subsequently be hindered by the discriminatory behaviour of contracting authorities in the selection and award stages of public procurement. The trade effect has a static dimension, since it emerges as a consequence of enhanced market access in the relevant sector or industry.

The competition effect relates to the changes in industrial performance resulting from changes in the price behaviour of national firms which had previously been protected from competition by means of preferential and discriminatory procurement practices. The competition effect derives also from the principle of transparency and appears to possess rather static characteristics. Transparency in public procurement breaks down information and awareness barriers in public markets, and as mentioned above, it brings about a trade effect in the relevant sectors or industries by means of price competitiveness. The competition effect comes as a natural consequence of price competitiveness and inserts an element of long-term competitiveness in the relevant industries in aspects other than price (for example, research and development, innovation, customer care). The competition effect will materialise in the form of *price convergence* of goods, works and services destined for the public sector. Price convergence could take place both nationally and Community-wide, inasmuch as competition in the relevant markets would equalise the prices of similar products.

Finally, the restructuring effect reveals the restructuring dimension and the re-organisational dynamics on the supply side, as a result of increased competition in the relevant markets. The restructuring effect is a dynamic one and refers to the long-term industrial and sectoral adjustment within industries that supply the public sector. The restructuring effect will encapsulate the reaction of the relevant sector or industry to the competitive regime imposed upon the demand and supply sides, as a result of openness and transparency and the consequential trade and competition effects. The response of the relevant sector or industry and the restructuring effect itself will depend on the efficiency with which the industry merges, diversifies, converts or aborts the relevant competitive markets and will also reflect contemporary national industrial policies.[28]

From the mid-1980s, the regulation of public procurement in the European Union became a priority. The inefficiency of the relevant primary and secondary Community provisions to combat discriminatory practices and preferential public purchases by contracting authorities throughout the common

[28] See European Commission, *The Opening-up of Public Procurement to Foreign Direct Investment* in the European Community, CC 93/79, 1995.

market was disclosed, as statistical results revealed significantly low cross-border import penetration in public contracts. Furthermore, a disturbing picture emerged as to the extent of differentiation of market access in public procurement opportunities in the member states of the European Union. Market access reflects the effectiveness of import penetration strategies (marketing, predatory pricing, venture alliances) by an undertaking and very much depends upon the regime of competition reigning in the relevant market place.

If scale economies were important in defining the most desirable purchasing pattern for the public sector and if competition were to increase amongst industries which supply the latter, an efficient European industrial structure would support fewer firms operating at full capacity.[29] Strategic mergers and cross-border investments would reshape the industries and reorganise the operation of firms. Within this reorganisation process, structural adjustment would constantly change in order to adapt to the new market environment introduced by the legal regime on public procurement. In the process of developing new industrial strategies, two factors appear essential: the need for integration of industrial activities[30] and the need to meet local demands.

In the past many of the advantages offered to national champions and locally operating firms in public procurement markets had discouraged the tradability of public contracts[31] amongst European industries.[32] Persistently low import penetration in protected public procurement sectors dictated a corporate strategy to the relevant industries. Before the opening up of public procurement in Europe, the typical strategic choice was low on integration and high on responsiveness, including the replication of all major corporate functions (production, research and development, marketing) in each member state. The on-going realisation of the common market and the regulation of public procurement in the European Union have been forcing undertakings to revise their strategies and to build up *network organisations* which combine local responsiveness with a high degree of centralisation and co-ordination of major supporting activities. The new strategy has the characteristics of a multi-focal strategy.

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[29] See Dunning, 'Explaining changing patterns of international production: In defence of the eclectic theory', *Oxford Bulletin of Economics and Statistics*, **41**(4) (1979), 269–95.

[30] See Dunning, *The Globalisation of Business: The Challenge of the 1990s*, Routledge, London and New York, 1993.

[31] The term tradability of public contracts denotes the effectiveness of the supply side in engaging in transactions with public authorities in member states other than the state of residence or nationality.

[32] See McLachlan, 'Discriminatory public procurement, economic integration and the role of bureaucracy', *Journal of Common Market Studies*, **23**(4) (1985), 357–72.

The adoption of multi-focal strategies or global integration strategies involves a major shift in location patterns of key functions within firms.[33] The old decentralised multinational organisations which duplicated major functions in each country in which they operated need to transform into an integrated system of which the key elements show a different degree of regional concentration.[34] As a consequence of the new organisational structure, different types of international transactions are expected to occur.[35] Specialisation and concentration of activities in certain regions will lead to more trade between certain member states. In addition, as a result of the corporate network system, trade will increasingly develop into intra-firm trade and intra-industry trade with greater exchange of intermediary products.[36] The organisational rationalisation following the development of network organisations may result in a problem of ownership and location of corporate headquarters. Some member states may fear losing strategic control in the restructuring process[37] and may therefore resist the rationalisation process that the industry has been undergoing, by imposing various restrictions in terms of ownership or control structures of locally operating firms.

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33 Porter, *The Competitive Advantage of Nations*, Macmillan, London, 1990.

34 Prahalad and Doz, *The Multinational Mission: Balancing Local Demands and Global Vision*, The Free Press, 1987.

35 Dunning, 'Multinational enterprises in the 1970's', in Hopt, *European Merger Contract*, de Fruyter, Berlin, 1982.

36 Vandermerwe, 'A framework for constructing Euro-networks', *European Management Journal*, **11**(1) (1989), 55–61.

37 Tirole, *The Theory of Industrial Organization*, The MIT Press, Cambridge, MA, 1988.