

## Chapter 10

# Law and Economic Analysis of the Estonian Public Procurement Act

*Ringa Raudla*

### INTRODUCTION

While the early years of transition in Central and Eastern Europe focused primarily on structural economic reforms (including stabilisation, liberalisation and privatisation) and restructuring the foundation of the political systems, the later phase of transition concentrated on the institutional changes in the public sector and administrative practices. Reforming the system of public procurement was one of the comprehensive changes the transition countries had to undertake when reforming their public administrations. Transforming the “state order system” inherited from the Soviet era – that had been based on entirely different principles given the very limited role of the private market in the planned economy – to a modern public procurement system was certainly a challenging task for the governments in Central and Eastern Europe.

In Estonia, the first comprehensive legislative act concerning public procurement was passed in 1995 and enacted in 1996, after overcoming the prevailing resistance among politicians who had first considered the act as an attempt to “re-introduce” a soviet-type centralised state-order system. According to Martinez-Vazquez and Boex (2000), one of the significant features of budgeting under planned socialism was the use of numerous spending norms, creating extraordinary rigidities in the resource allocation process. Until the mid-1990s, the memory of strict political control of the bureaucracy by a parallel party structure was still vivid (cf. Norgaard & Winding, 2005). Thus, the fact that an attempt to “bring back” regulations concerning the purchasing activities of the public sector organisations was initially met with some sceptical resistance is understandable. On the other hand, however, there was growing realisation that in order to make the public procurement practices

more efficient, better legislative guidance had to be offered to the administrators. It was seen as necessary for both making the expenditures of the state more transparent (and thus moving away from a “secretive” style of soviet administration) as well as contributing to more rational management of public expenditures. Becoming familiar with the international practices and examples from other countries also facilitated the introduction of public procurement regulation in Estonia. The Public Procurement Act in Estonia was prepared with the help of the expertise from the World Bank and followed the UNCITRAL Model Law on Procurement of Goods, Construction and Services.

After the enactment of the Public Procurement Act in 1996, the issue of public procurement became increasingly important in the public discourse, as exemplified by the increasing number of articles dedicated to the issues of public procurement in the media – often focusing on the government contracts where the Act had been violated. The report by Open Society Institute (2002) on corruption in Estonia noted that although corruption in Estonia was not such a major concern, there were notable problems in the area of public procurement, and that the public procurement process appeared to be particularly vulnerable to corruption.

In 1999-2001 several changes were made to the Estonian Public Procurement Act, including, *inter alia*, lowering the value thresholds of procurements above which the contracting authorities have to follow the procedures of the Act, changes to the tendering procedures, and introducing consolidated procurement. At the end of 2003, however, these particular provisions were abolished or changed. This chapter uses the approach of law and economics to analyse the Estonian Public Procurement Act and in particular the goals and effects of the changes made to the law in 1999-2001. Law and economics analysis can be regarded as especially useful for case studies in public administration and public policy since it is “decidedly realist in impetus” with an aim to address “not what is, but what really is” (Drechsler, 2002, p. 400).

The second section outlines the methodological framework of law and economics analysis that will be the basis for the case study of the Estonian Public Procurement Act. Following the three different strands of analysis in law and economics – economic reconstruction of the legal argument (positive analysis), evaluative analysis, and

normative analysis – the Estonian public procurement policy is examined in the subsequent section, with the main focus on the changes made to the Public Procurement Act in 1999-2001. The discussion considers the findings in the light of the general problems involved in carrying out administrative reforms during the transition.

### METHODS

Law and economics refers to the economic analysis of law on the one hand, and to the study of how law influences economic matters on the other. An array of different methods and categorisations of various approaches have been listed in the law and economics literature. For most part, the views of different scholars overlap in their way of making distinctions between the various approaches.<sup>1</sup> What has been chosen as the methodological framework for this chapter is the one offered by Jürgen Backhaus (1999). Backhaus makes a distinction between three different kinds of analysis: positive analysis of legal structures (economic reconstruction of the legal argument), evaluative analysis, and normative economic analysis. This framework is chosen because it encompasses the main approaches of law and economics usually brought out in the literature and does so in a well-elucidated way, thus generating very practical methodological guidelines.

The positive analysis that seeks to reconstruct the structure of a legal argument aims at illuminating complex legal reasoning that cannot be reduced to one or few organising principles of legal doctrine (Backhaus, 1999). This analytical approach can offer new insights in the law by applying economic concepts and theories (Mackaay, 2000b). By putting forth a new analytical structure, law and economics can provide a different way of looking at the legal issue (Klevorick, 1975) and enhance our understanding of the law or policy.

The evaluative analysis endeavours to analyse the consequences of a particular legal decision or a set of decisions (Backhaus, 1999). The consequences here do not have to be only economic: the evaluative analysis seeks to look at all consequences of an act or policy, regardless of whether it concerns the impact on the economy or on other spheres. Backhaus (1999, pp. 466-467) emphasises that the purposes of a particular decision or rule need to be strictly differentiated from the outcomes of that decision or rule: “A frequent

misunderstanding grows out of the assumption that the two coincide, and it is often the task of the economist to show how and why they do not." Dolan and Goodman (1995, p. 2) stated that one of the most characteristic economic ways of thinking about law and public policy is an "insistence on tracing the unintended, often hidden, consequences" of public policies and the laws involved. Thus, an evaluation with the aid of economic analysis can make major contributions in providing answers to such questions as the following: What are the likely effects of a proposed law? What were the effects of the existing law? Have its objectives been obtained?

Usually, one cannot determine the effect of law by simply looking at the law itself and at the conduct it requires, but one must also determine how people will respond to the law (Arlen, 1998).<sup>2</sup> The task can be quite challenging, because people react to public policies in different ways. Dolan and Goodman (1995) emphasise that people do not only attempt to do the best they can to achieve their goals, given the constraints that circumstances place on them, but also look for ways to break through constraints by inventing new techniques, devising new ways of organisation and experimenting with new ways to achieve their goals. Thus, in analysing the effects of an existing policy or predicting the effects of a new policy, it is important to look how these different responses influence the actual outcomes.

The task of the third approach – the normative analysis – is “to explore the relationship between the various value judgements underlying legal discourse and to indicate where and how they may be in conflict” (Backhaus, 1999, p. 272). If, for example, a particular value judgement is given priority over others, the normative analysis can show to what extent this priority will compromise the attainment of other traditional goals. The normative approach used here provides a basis for a more extensive analysis than is often proposed in some law and economics literature where the criteria for normative decisions about a particular law or policy only include the different measures of efficiency, be it Pareto optimality, Pareto superiority or potential Pareto superiority. As David Friedman (1989, p. 28) stated, “economic efficiency is not an instantly compelling moral end to which all good men must adhere.” A broader approach allows focusing better on the tradeoffs between different desirable goals.

In the following analysis, the focus is first on how to use the concepts and models of law and economics for explaining the

different roles and functions any Public Procurement Act should comprise. The chapter proceeds by looking at the general goals of the Estonian Public Procurement Act as expressed by the legislature and integrate the first step of evaluative analysis (focusing on what the expressed goals are) and normative analysis by looking at whether the expressed goals are in fact desirable and whether they are consistent with each other. In the light of the general goals, the more specific goals attached to some of the changes introduced to the Act in 1999-2001 are then explored together with the assessment of what the actual effects of the changes were and whether the set goals were achieved.

The main sources for gathering data for the case study of the Estonian Public Procurement Act were the explanatory notes to the drafts of the Act, the stenographs of the debates on the Act in the Estonian parliament (the Riigikogu), the protocols of the parliamentary economic affairs committee, the interviews made with the involved policy-makers by the media, the yearbooks of the Public Procurement Office (including statistics on public procurement), and personal communication with a chief specialist of the Public Procurement Office.

## RESULTS

### Positive Analysis of the Public Procurement Act

As pointed out in the previous section, law and economics analysis can be used for gaining new insights by applying economic concepts and theories to a particular law or policy, and reconstructing the problems in economic terms. Thus, law and economics analysis can provide a better understanding of the issues involved in the Estonian Public Procurement Act in particular and in public procurement policy in general by drawing on the economic concepts to illuminate the problems and viewing them through a different analytical structure. The main focus areas of the Neoinstitutional law and economics – transaction costs and agency problems (cf. Klein, 2000; Mercurio & Medema, 1997) – can be particularly fruitful for enhancing the understanding of the underlying issues in public procurement and pointing to important aspects that have to be kept in mind when designing a law regulating public procurement.

### ***Transaction Costs and Public Procurement***

The concept of “transaction costs” was first brought up as a relevant factor for economic analysis by Coase (1937) and has been developed further and expanded by Williamson (1975, 1985, 1986), Klein, Crawford and Alchian (1978), Grossman and Hart (1986), to name but a few key works. Transaction costs cover two kinds of costs: those for evaluating the characteristics of the object of the exchange (information and measurement costs) and those for monitoring and ensuring the implementation of the agreements (implementation costs) (Mattei, Antonioli & Rossato, 2000). The information and measurement costs include, for example, the material expenses and the opportunity cost of time and energies necessary to reach an agreement on the transfer of a right (Parisi, 1999), and implementation costs involve all the costs necessary for an effective monitoring of the other party's performance (Cooter, 1987). The concept – although originating from the analysis of firms – has been extended to regulatory contexts and to the operation of the government itself (Mackaay, 2000a) as exemplified by the question of “make or buy” being extended to the analysis of government activities.

The transaction costs perspective can shed light on the question of why it is necessary to regulate the way public procurement is carried out. Ulen (1997) points out that if transactions were costless there would be no need for laws regulating contracts, but when the costs of arranging those agreements are high, potential contractors need assistance in structuring agreements. To put it even more strongly, it can be argued that if it is socially desirable to favour whatever arrangement involves lower transaction costs, the role of the law is to replicate the optimal results of a rational bargain (Lowry, 1976). Laws can reduce transaction costs by devising rules that guide behaviour and by creating incentives and sanctions that render implementation easier (Mattei, Antonioli & Rossato, 2000). Thus, a law regulating public procurement can be seen as a way to lower transaction costs by “making choices repetitive.” by prescribing the search mechanism the representatives of public bodies are supposed to undertake in order to get a “rational” bargain. Without clear guidelines government agencies would be likely to come up with their own procedures, thus duplicating the costs of designing well-working rules that could instead be uniform for all agencies within the government. In a way, a public procurement act “forces” the

purchasing agencies to be “rational” in the contracting process by prescribing what factors to look at in case of potential tenderers and by making them go through a thorough search process in order to find the best offer. Furthermore, the act can lower transaction costs for the potential bidders: instead of having to follow a whole array of different sets of rules stipulated by the various bodies, they have to follow a unified set of guidelines, making it easier to prepare the bids. At the same time, however, by providing such precise guidelines, the act may introduce additional transaction costs by making the obtaining of information more expensive. Thus, when devising the specific rules that govern the conduct of procurement, it is necessary to keep in mind whether a particular guideline is helpful for gaining information that is essential for the contracts and how expensive it is for the purchaser to gain this information (or for the tenderer to provide this) and what the trade-off is between the costs and usefulness.

In particular, the concept of transaction costs might be helpful in devising tendering procedures and prescribing when and where a particular procedure should be used – especially in analysing what factors enhance the relative attractiveness of competitive bidding vis-à-vis the alternatives. As Goldberg (1977) puts it, competitive tendering is one of the several devices for transmitting information between organisations, alongside with negotiated contracts, institutional advertising, and vertical integration by contract. In its simplest form, it is a price-searching device, but as the complexity of the transaction increases, the relative significance of the price term will diminish. Thus, as Goldberg emphasises, the properties and relative efficacy of competitive bidding mechanisms will depend crucially on the subject matter of the bidding competition – especially on the complexity of the service or product being contracted. He adds that treatments of competitive bidding in which the details of the pre-contractual bidding process are neglected or suppressed might easily lead to “excessively sanguine views on the merits of bidding” (Goldberg, 1977, p. 251).

When looking at the transaction costs involved in bidding procedures, several costs can be brought out. Search costs in the form of putting together the call for tenders, soliciting and evaluating bids, costs arising from the producer’s search efforts, bid preparation costs etc. In competitive bidding for complex contracts, the conveyance of sufficient information to ensure that the potential

suppliers put together bids that in fact satisfy the needs of the contracting authority, is likely to be a substantial problem. The cost of transferring information will influence both the relative efficacy of alternative bidding mechanisms and the relative merits of competitive bidding versus non-bidding alternatives. (Goldberg, 1977)

Thus, the transaction costs perspective could be helpful in designing the tendering procedures and prescribing the criteria for choosing a particular tendering procedure. It is not claimed here that transaction costs should be the only basis for judging the merits of different tendering procedures, but it can certainly help to clarify the costs involved in conveying information, and direct the attention of those devising the rules to whether a particular requirement is in fact helpful in achieving the purpose for which it is put in place. Transaction costs should also be kept in mind when prescribing the value thresholds above which the procurements have to be conducted in accordance with a public procurement act.

### ***Principal-Agent Problem and Public Procurement***

The role of the Public Procurement Act can also be described in terms of the agency theory and the related problem of asymmetric information (Akerlof, 1970), giving rise to moral hazard and adverse selection. An agency relationship is established when a principal delegates some rights – for example user rights over a resource – to an agent who is bound by a formal or informal contract to represent the principal's interests in return for payment of some kind (Eggertson, 1990). The central problem of agency is that the goals of the agent may not correspond exactly to those of the principal, which necessitates some sort of monitoring to ensure that the agent's behaviour reflects the principal's interests. Because monitoring is costly, however, it is usually unfeasible or impossible for principals to perfectly monitor agent performance (Mercuro & Medema, 1997)

Thus, in a typical agency model, a principal assigns an agent to do some task, but has only some imperfect signals of the agent's performance (Klein, 2000). This kind of asymmetric information may give rise to the problem of moral hazard. Moral hazard denotes perverse incentive effects (McAfee & McMillan, 1988) or malfeasance by agents, expressed for example when the agents use their discretion to shirk or otherwise pursue personal objectives (Klein, 2000). Moral hazard may arise “when individuals engage in



risk-sharing under conditions such that their privately taken actions affect the probability distribution of the outcome” (Holmström, 1979, p. 74), or differently put, when one party’s actions have consequences on the risk of loss borne by another (Baker, 1996). According to Holmström (1979) in these instances Pareto-optimal risk sharing is often precluded, because proper incentives to take correct actions are not induced because individual actions cannot be observed and hence contracted upon.

In the case of public procurement, it is even possible to talk about a “double” principal-agent problem. On the one hand, it can characterise the relationship where the parliament delegates the decisions on procurement to the agencies, thus making the legislature “principal” and the bureaucrats “agents”. Since the officials carrying out the procurement have no direct interest in the way the money gets spent on public contracts, they may not have sufficient incentives to carry out a thorough process in searching for the best offer. Thus, by prescribing specific procedures, the use of which can be reviewed by third parties (e.g., a Public Procurement Office) the act can mitigate the hazards associated with the principal-agent relation between the legislature and the bureaucracy. On the other hand, the relationship between the agency and the contractor can also be seen as having the features of principal-agent problem because of the limited resources the governmental offices have for monitoring the completion of the contract. Moral hazard in this case arises when the contractor’s incentives and the government’s objectives are not well aligned and the government cannot perfectly observe the actions of the contractor – for example, if the firm makes a bigger profit by being inefficient in carrying out the contract but the government officials cannot monitor the effort sufficiently enough to detect such behaviour (Dertouzos, 1994), or if the contractor does not exert efforts to hold down costs (McAfee & McMillan, 1988). Thus, a public procurement act can help with “incentive alignment” (Mercuro & Medema 1997, p. 144), inducing the agent to perform in a manner that corresponds more closely to the principal’s interests. For example, by prescribing bid evaluation criteria that involve looking at whether the particular supplier has so far carried out the public contracts as specified, it can provide appropriate incentives and elicit desirable behaviour.

A public procurement act can also aid in reducing the risk of adverse selection. Adverse selection arises when the government

cannot perfectly observe what “type” of firm it is dealing with due to the fact that the government typically has incomplete information about the contractor’s actions or type (Dertouzos, 1994). Thus, adverse selection in case of public procurement may occur when the decisions to which firm a contract should be awarded are based primarily on the price-criterion. In this case, it may often be the inefficient firm (who is not capable of accurately assessing the actual costs of completing the contract) who wins the contract. By prescribing the qualification criteria including, for example the financial status and technical competence of the tenderer, the act can reduce the problem of adverse selection by soliciting information on the capabilities of potential bidder. Furthermore, by providing the possibility of restricted tendering procedure, the act can allow the public officials to pre-screen potential bidders and restrict the bidder competition to a list of acceptable bidders.

For most part, the Estonian Public Procurement Act as a whole fulfils the functions discussed above, by offering guidance for rational decision making, prescribing the criteria for qualifying the bidders, and stipulating monitoring procedures. Generally (except for the provisions discussed below) the concerns of agency and transaction costs have been balanced in a satisfactory manner.

As will be seen in the analysis of some specific provisions Public Procurement Act in the next sections, the concepts of transaction costs and agency in fact played an important role in the process of how the provisions came about and why they were eventually abolished. Although the policy-makers involved did not discuss the issues in the exact terms of “agency” and “transaction costs”, the underlying ideas of these concepts often guided the political decision-making. While the concerns of agency dominated the reasoning behind the lowering of the value thresholds, the provisions on consolidated procurement sought to lower the transaction costs (although not successfully). With regard to the tendering procedures, there was an attempt to balance the principle of lowering transaction costs and monitoring the agents, but due to the interaction of different provisions, and a too limited role provided for the Public Procurement Office, the control over the agents was clearly weakened.

### **Evaluative and Normative Analysis of the Estonian Public Procurement Act**

Before analysing the effects of some of the main changes made to the Public Procurement Act in 1999-2001, it is necessary to bring out what general goals were set by the policymakers (especially the legislature) in formulating the Act. In analysing the expressed goals, the elements of normative analysis in law and economics are applied. Special attention is paid to the question of whether there is a conflict between the value judgements underlying the different goals (cf. Backhaus, 1999), and how adequately the problem of conflicting goals has been addressed. In addition, the analysis seeks to establish whether the particular goals set for the Public Procurement Act might compromise other traditional goals of public procurement, and whether some of those important goals have been omitted.

#### ***General Goals of the Public Procurement Act***

The first Public Procurement Act adopted in 1995 actually contained a paragraph stipulating the purpose of the Act. It was stated that “the purpose of the Act is to ensure the most rational and economical use of the financial resources intended for public procurement”. However, the amended Act initiated in December 1999 and adopted in October 2000 did not contain that provision anymore and no other reference was made to the general purposes of the Act. Still, in the first explanatory note of the draft of the amended Act it was emphasised that the aims of the changes were to harmonise the Public Procurement Act with the directives of European Union, make it compatible with the requirements of the treaty with the World Trade Organisation, and solve the problems that have occurred in the operation of the existing Public Procurement Act. In the explanatory note to the second draft it was stated, in addition, that the Public Procurement Act should ensure expedient use of taxpayers’ money, encourage fair competition and not hinder entrepreneurship.<sup>3</sup>

The very question about the goals of the Public Procurement Act was discussed by the parliament during one of the debates on the Public Procurement Act (April 5, 2000). As a response to the presentation of the draft by the Minister of Economic Affairs Mihkel Pärnoja (the Moderates Party), in which he stated that the general goal of the Public Procurement Act would be specific and precise

regulation and supervision of the use of taxpayers' money by purchasing entities, Jüri Adams (a member of the Riigikogu, Pro Patria Union) came up with the question of why Estonia needed the Public Procurement Act in the first place. He pointed out that "in principle, Estonia could be without the Act and everything would get purchased in one way or another" and asked: "What is the merit or the essential advantage behind the thought, or what are we striving for with the aid of the existence of the Act?" In his answer Pärnoja emphasised again that because the purchasing entities are using the taxpayers' money for carrying out public functions, the Act strives to mitigate the weak "personal" relationship between the official and the purchase giving rise to insufficient incentives to use the money effectively and expediently. The co-presenter of the draft, the head of the Riigikogu economic affairs committee, Kalev Kallio (the Centre Party), in answering the same question, stated that the goal of the Act is to acquire the goods and services bought with taxpayers' money as advantageously as possible. In his follow-up speech, Adams addressed the answers to his question and admitted that he was somewhat disappointed by the fact that only one goal was brought out by both presenters, and that in fact two other goals should also be considered. First, the goal of the Act would be to make the purchases transparent, so that everybody could see who decides what gets bought, what the price is etc. Second, the Act should ensure that new firms have, at least formally, equal opportunities for entering the market where they have to compete with already established firms (Stenograph of the Riigikogu, April 5, 2000). In discussions on the Public Procurement Act half a year later, September 13, 2000, Minister Pärnoja, while presenting the draft, emphasised the goal of transparency. Specifically, he stated that the regulations in the Act are necessary for gaining sufficient information on how goods and services are purchased, in order to judge the correctness and expediency of the purchase (Stenograph of the Riigikogu, September 13, 2000).

Thus, the main objectives set by the legislature when making substantial changes to the Public Procurement Act were the following: expedient and efficient use of taxpayers' money, transparency, encouraging new entrants, and fostering competition. However, no real discussion was held on how to balance the goals of transparency and the economical use of money when they come into conflict.<sup>4</sup> At the initial stages of the legislative debates, ensuring the economical

use of money was emphasised as a main goal, in later discussions the focus was more on transparency, but no explicit prioritising took place.

Furthermore, the goals mentioned above cannot be regarded as genuine end-goals in an analytical sense. Rather they should be seen as instrumental goals for achieving further goals, e.g., enhanced legitimacy, increased welfare and wellbeing of the people, economic growth etc. In particular, one of the goals of transparency – enhancing the legitimacy of government – should have received more attention. The preamble to the UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994) states among other objectives the promotion of public confidence in the procurement process. The European Commission (1996, 1998) has also emphasised that a good public procurement policy can give taxpayers confidence that their money is being spent correctly and thus reinforce public trust in government.

It is also relevant to ask here, what other goals and objectives should have received more attention in the Estonian legislative discussions. What was certainly missing in the discussions was the question of how public procurement policy itself could be used as a tool in other policy areas – e.g., social policy, regional policy, environmental policy.

What has received growing attention in the public procurement literature and has also been recognised by the European Union (cf. European Commission, 1998) is how to incorporate the goal of encouraging and supporting small and medium-size enterprises (SMEs) into public procurement policy. SMEs have been identified as a significant component of economic strategies for employment and innovation (Fee, Erridge & Hennigan, 2002), and as a very important part of the agenda of regional development policies, since they are often located in less favoured regions, or regions of economic decline and industrial restructuring (Bovis, 1998). Erridge, Fee and McIlrow (1998), for example, have argued that since small firms may have a comparative advantage in the earlier stages of inventive work and less expensive more radical innovations, greater SME involvement in public purchasing will lead eventually to greater innovation, adding value and reducing costs.<sup>5</sup> Thus, the relationship between SMEs and public procurement is mutually beneficial and provides a rationale for encouraging greater involvement. The public sector can offer

attractive, stable contracts and accreditation through association while small firms offer the best potential job growth and innovation (Fee, Erridge & Hennigan, 2002). The dilemma for policy makers is how to encourage the participation of SMEs while remaining within the framework of fair competition. Although the encouragement of new entrants was noted as a goal in the Estonian legislative discussion on public procurement, no specific attention was paid to the question of SMEs and how to encourage their participation in the market by using public procurement.

In addition to being a possible instrument in supporting SMEs, as the European Commission has brought out in its *Green Paper* (1996) and Communication (1998), public procurement rules can contribute to the achievement of social policy objectives – for example, the equality of opportunity between men and women, stronger economic and social cohesion, better living and working conditions, a high level of health protection, and the integration of the disabled and other disadvantaged groups into society – since public procurement is a tool that can be used to influence the behaviour of economic operators. Social criteria can play a role in contract award procedures, particularly through the possibility of including the obligation to comply with existing social legislation or requiring the successful bidders to comply with social obligations when performing contracts awarded to them. None of the social policy considerations was brought out during the legislative debates over the Public Procurement Act. The Act stated that the contracting authority has to treat all persons participating in a public procurement tendering procedure equally, and there was no further legislative discussion over “positive action” and when it could be taken. The only provision that seems to have been formulated with some “social policy” objective in mind was a provision, which allowed the state agencies, local governments and local government agencies to purchase goods and contract for services from a penal institution (or a company founded by the state for the administration of the production units of a penal institution) without having to apply the procedures of the Act when the value of the procurement was below 500,000 kroons (equal to 32,000 euros) which was a higher threshold than the 100,000 kroons (equal to 6,400 euros) above which the procuring entities had to follow the procedures of the Act.

### ***Goals and Effects of the Changes Made to the Public Procurement Act***

The reform of the Public Procurement Act in 1999-2001 introduced a number of changes to the Act initially adopted in 1995. The analysis focuses on the objectives and effects of the changes made to the value thresholds of procurement to which the Act applies, on the changes in tendering procedures, and on the introduction of consolidated procurement.

#### ***Lowering Value Thresholds***

The Public Procurement Act adopted in 1995 delegated the decision-making on value thresholds of public procurement – purchases above which the contracting authorities have to follow the procedures of the Act – to the Government of the Republic (i.e., the Cabinet). The changes introduced in 1998, following international traditions that envisage the specification of such thresholds on the statutory level, incorporated the thresholds into the Act, setting it at 200,000 kroons (equal to 13,000 euros) for goods and services and 2 million kroons (equal to 128,000 euros) for construction contracts. However, the Act adopted in 2000 lowered the thresholds to 50,000 kroons (equal to 3200 euros) for goods and services (though again increased to 100,000 kroons (equal to 6,400 euros in March 2001), and 500,000 kroons (equal to 32,000 euros) for construction work.

The main aim of the lowered value thresholds, according to the presenter of the draft at the Parliament, the Minister of Economic Affairs Mihkel Pärnoja, was to prevent the purchasing bodies from dividing the objects of purchase into separate parts in order to avoid having to follow the procedures prescribed by the Act (Stenograph of the Riigikogu, February 9, 2000; June 6, 2000). When the question of the lowered thresholds came up in the meeting of the Riigikogu Economic Affairs Committee, Kalev Kukk (member of the Riigikogu, Reform Party) suggested limiting the scope of the Act and making the procedures applicable only to the procurements when the value exceeds the international value thresholds (i.e., 130,000 euros or 600,000 euros for goods and services, depending on the contracting authority, and 5 million euros for construction contracts) as is done in Ireland. The Minister answered that this kind of approach would be inapplicable due to general distrust towards the government, and because without regulation the resources would not be used

expediently. (Protocol of Riigikogu the Economic Affairs Committee of the Riigikogu No. 14, March 8, 2001)

To what extent, however, did the lowered thresholds discourage the division of procured objects into several parts and promote transparency and economical use of resources? It is difficult to ascertain how many such divisions still continued to take place because state agencies had incentives to hide that information, but according to some assessments, the practice was still widespread (cf. Ojasson, 2001). Also, if a contracting entity decided to defy the procedures stipulated by the Act, the lowered value thresholds in themselves did not pose such strong obstacles to the practice. Due to asymmetric information between the contracting authorities and the Public Procurement Office (that is responsible for monitoring the public procurements), a contracting authority could still get away with dividing the object of procurement into parts, with the only difference that the parts into which the object gets divided had to be somewhat smaller.

Dividing the object of procurement into separate parts has also been encouraged by the confusion over the Public Procurement Act in regulating which objects should be procured together and for which objects separate procurement is allowed (Ojasson, 2001). The Open Society Institute Report on Corruption in Estonia (2002) noted that although the Act forbade dividing contracts into smaller parts, this was very difficult to monitor and the Act was not sufficiently clear to allow the Public Procurement Office to intervene in questionable cases. Furthermore, the Act did not require further explanations from the contracting authority when several contracts for goods and services, the value for which fell below the value threshold, were formed with the same provider, thus leaving a convenient loophole for contracting authorities (Neudorf, 2003).

In addition, lowered thresholds may actually work against the general goal of economical use of resources. As can be seen from Table 1, the number of procurements increased sharply after the changes made to the Public Procurement Act came into force in 2001.

Especially in case of procurements of lower value, the administrative costs constitute a significant percentage of the overall cost of the procurement and may in fact result in higher total costs



**TABLE 1**  
**Number and Value of Procurements (In Million Euros)**

Year	1998	1999	2000	2001	2002	2003	2004
Nr	1684	1852	1805	3111	4349	4859	4900
Value	281	294	302	430	475	658	487

Source: Public Procurement Office (2001, 2002, 2003, 2004, 2005).

than if the object were procured without following the prescribed procedures. In addition, as Silvia Anso (a chief specialist at the Public Procurement Office) has brought out, lower thresholds prevented the officials from focusing their efforts on larger procurements since the small procurements took up a lot of time (Simson, 2002).

Furthermore, since participating in the tendering procedure also incurred costs for the tenderers, the increased number of public procurement tendering procedures may have led to increased overall costs for the firms participating in the tendering procedures. Following the argument developed by Goldberg (1977), it can be suggested that if all costs are placed on potential providers in the sense that the purchaser will not compensate for information produced, and if the providers provide similar services to other customers, it is very likely that the costs of providing information and preparing unsuccessful bids will eventually be passed on to the final customers – to the private customers or to the contracting entities themselves. Consequently, lowering the threshold levels may have the unintended effect of making the cost of the good or service more expensive for the contracting authority or if the cost is shifted to other consumers, making the products more expensive for them.

On the other hand, as a positive side effect, lower value thresholds may have promoted the participation of SMEs in the tendering procedures. However, the effect might have been reduced by the fact – analysed at greater length in the next subsection – that in cases of procuring goods and services of lower value the contracting entities often used the negotiated tendering without prior publication of the tender notice which may not have necessarily led to choosing SMEs as negotiation partners.

Consequently, it is not clear that the lowered value thresholds significantly contributed to lessening the number of cases where the object of procurement was divided into separate parts – thus not achieving the goal that it was intended to achieve. Furthermore, lowered thresholds worked against one of the general goals of the Public Procurement Act – the economical use of resources – by increasing the administrative costs involved in public procurement and making the procurement of objects of lower value relatively more expensive. With the amendments made by the Riigikogu in November 2003, the value of the thresholds was increased to 300,000 kroons (equal to 19,000 euros) for goods and services and 2 million kroons (equal to 128,000 euros) for construction contracts.<sup>6</sup>

### ***The Changes in Tendering Procedures***

The Public Procurement Act that was in force from 1996 until 2001 made a distinction between open tendering, two-stage tendering, negotiated limited tendering, and single-source public procurement.<sup>7</sup> The changes made to the Act in 1999-2001 abolished two-stage tendering and single-source public procurement, changed the name of negotiated limited tendering to negotiated tendering with prior publication of tender notice, introduced restricted tendering procedure (whereby only the suppliers selected by the contracting authority are invited to submit tenders), and negotiated tendering procedure without prior publication of tender notice. Also, more specific criteria for choosing between the procedures were stipulated. In general, the open tendering procedure had to be used, and the use of other tendering procedures was permitted only in those cases provided for by the Act.

One of the aims of making amendments to the tendering procedures was to reduce the number of single-source (or sole-source) procurements in order to enhance transparency and encourage competition. Already in amending the Public Procurement Act in 1998, the presenter of the draft, the Minister of Economic Affairs, Jaak Leimann (Estonian Centre Party), emphasised that the goal was to promote the use of open procedures, and to ensure that limited procedures would be used only in exceptional cases (Stenograph of the Riigikogu, March 10, 1998). What was considered especially problematic was the extensive use of single-source procurement (Tooming, 1998). The explanatory note to the draft act initiated in December 1999 also emphasised the connection between

open procedures and transparency. The explanatory note to the draft act amending the Public Procurement Act initiated in February 2001 pointed out that in cases where a negotiated procedure without prior publication of notice is used, the Act seeks to ensure openness and transparency by demanding that the contracting authority notify the Public Procurement Office (by publishing the information in the Register of Procurements).

The initial Public Procurement Act of 1995 allowed single-source procurement after receiving a consent from the Public Procurement Office, for example in cases where the required object of public procurement was available from only one procuring entity; there was an urgent need for a specific object; or where additional contract was granted to the same tenderer because of standards or compatibility. In 1997 it was added that the qualification of the tenderer has to be checked before asking the permission from the Public Procurement Office. The Public Procurement Act adopted in 2000 did not contain the “single-source tendering procedure” anymore. Instead, it set out the conditions allowing negotiated procedure without prior publication of the tender notice, stipulating that the contracting authority may negotiate with as many tenderers as the contracting authority considers necessary, which in essence allows having negotiations with one tenderer only. The chapter brought out several conditions when the use of this kind of procedure was allowed, including for example, emergency situations, or if additional goods are purchased from the initial tenderer in order to either partially replace or supplement the goods purchased previously and a change of tenderer would entail the purchasing of goods which are technically incompatible, or if goods can be purchased or services or construction work contracted for only from one particular tenderer, etc.

Setting the goal of increasing the use of open procedures would imply that the increase should come from using negotiated tendering procedures and restricted tendering procedure less frequently. Whether a decrease in the use of procedures involving negotiation or restricted procedures should be a goal in itself requires more attention because here the clash between transparency and economic use of resources comes to the fore most clearly. On the one hand, the traditional argument for requiring governments to award contracts through open-tendered bidding is that competition among bidders ensures that all the gains from trade are realised (Johnson,

1990). On the other hand, it can be argued that although the use of open tendering procedures may promote transparency, it may undermine the goal of economical use of resources. As McAfee and McMillan (1988) have argued, the requirement of accountability and visibility usually rules out closed negotiations, but at the same time, negotiations can provide flexibility – for example, arrangements for sharing risks can be made. Warrilow (1995) emphasises that although it may necessary to restrict negotiations with bidders, such a measure does not always serve the interests of economy and efficiency – for instance, it may prevent procurement staff from negotiating more advantageous conditions for their organisations.

Thus, there are several further considerations that should have received attention in the legislative discussion. In particular, in designing the tendering procedures, more attention could have been paid to how to achieve balance between transparency and economical use of resources.

To what extent, however, was the aim of the changes to the tendering procedures – promoting the use of open tendering and restricting the use of less competitive procedures – achieved? As can be seen from Table 2, the use of the least competitive procedure increased over time after the changes in tendering procedures came into force in 2001.

As emphasised in the media – the use of the least competitive procedure became a rule rather than exception (Eesti Päevaleht, 2002; Ojasson, 2001). Thus, the changes to the Act led to a perverse effect – exactly the opposite effect of what was sought.

The main reason for the increase of the proportion of the least competitive procedure – the negotiated tendering procedure without prior publication of tender notice – was that one of the conditions under which the use of this procedure was allowed was when the

**TABLE 2**  
**The Use of the Least Competitive Procedure (% of All Procurements)**

Year	1997	1998	1999	2000	2001	2002	2003	2004
%	31	39	25	24	39	52	53	9

Source: Public Procurement Office (2001, 2002, 2003, 2004, 2005).

estimated value of the public procurement together with value-added tax was up to 200,000 kroons (equal to 13,000 euros) per year in the case of purchasing of goods or contracting for services or up to 2 million kroons (equal to 128,000 euros) per year in the case of contracting for construction works (§57 Subsection 1 Sub-point 13). Thus, although the negotiated tendering procedure without prior publication of the tendering notice was initially planned to be used in case of emergencies, and in some other very specific cases where procurement from one tenderer would be justified, Sub-point 13 in effect allowed the contracting entities to use this procedure whenever it wanted as long as the value fell under the stipulated thresholds. The director of the Public Procurement office, Ülo Sarv, admitted that most of the uses of negotiated tendering without prior publication of the tender notice were justified with the reference to the Sub-point 13 (Eesti Päevaleht, 2002).

According to the Minister of Economic Affairs Mihkel Pärnoja, this provision was supposed to allow a more flexible approach to the public procurement while at the same time enabling supervision and review (Stenograph of the Riigikogu, June 6, 2000). **The purchasing authorities were required to submit a notice concerning the use of this procedure to the register of procurements before the commencement of negotiations.** The notice had to include the name and characteristics of the object of the public procurement, the estimated value of the public procurement, information on the tenderers selected by the contracting authority, and the grounds for the selection of the tendering procedure. However, the mere obligation to submit the required information did not in itself guarantee effective control or surveillance over the use of the procedure. Even if the contracting entity did submit all required information, there was in fact little that could be done, even if the Public Procurement Office or other potential suppliers disagreed with the choice of the negotiated procedure without prior publication of the tender notice. In fact, in cases where the value of the procurement fell below the thresholds stipulated in Sub-point 13, there were no grounds for contesting the use of this procedure, and no grounds for claiming that the Act had not been followed. Furthermore, according to the Act, it was not possible to submit protest to the Public Procurement Office concerning the choice of tender procedure. Thus, appeals regarding that decision could only be filed with the Administrative Court, and so far there have been no

such precedents. The main way the Public Procurement Office could exercise supervision over the choice of tendering procedures was the inspection of the contracting authority (e.g., without giving prior notice) where it could check whether the choice of the tender procedures was justified or not, and apply appropriate sanctions. Given the large number of procurements taking place, however, the Office could only inspect a small percentage of the cases. (Personal Communication with a chief specialist of the Public Procurement Office, April 5, 2003).

Thus, since the negotiated procedure without prior publication of the tender notice was the most convenient procedure for the contracting authorities and there was no real barrier to using it when the expected value of the object of procurement was below the given thresholds, it should not have been so surprising that the procedure was used so extensively. Such a widespread use seems to have come as a real surprise to some of the political actors. For example, the Minister of Economic Affairs, Liina Tõnisson (Estonian Centre Party), was so disappointed with the extensive use of this procedure that she submitted a proposal to Riigikogu in August 2002 to abolish the Sub-point 13 (Eesti Päevaleht, 2002). The proposal, however, did not progress beyond the Riigikogu Committee of Economic Affairs. Only in November 2003 was the Sub-point 13 abolished, together with increasing the value thresholds for which the Public Procurement Act applies (cf. above). As can be seen from Table 2, after the abolition of Sub-point 13, the percentage of using the least competitive procedure dropped drastically from 53% in 2003 to 9% in 2004.

Whether the annulment of this provision *alone* – without increasing the value thresholds at the same time – would have been desirable, is questionable. This provision enabled the contracting entities to avoid the relatively large administrative costs in case of lower-value procurements, thus perhaps mitigating some of the possible adverse effects of lowered value-thresholds. If the provision had been repealed without increasing the value thresholds at the same time, the actual effect of the lowered thresholds would have come to the fore at full extent by further increasing the workload of contracting authorities, and costs incurred by the use of other more expensive tendering procedures. On the other hand, however, since such a significant proportion of procurements were carried out without actual competition, it may have devalued the very notion of public procurement, and undermined the public trust towards

government authorities. As McAfee and McMillan (1988, p. 6) note, public contracting must not only be conducted honestly, but also “has to be seen as conducted honestly”.

### ***Consolidated Public Procurement***

One of the significant changes made to the Act in 1999-2001 was the introduction of the provisions concerning consolidated procurement. The presenter of the draft at the Parliament, Minister of Economic Affairs Mihkel Pärnoja, brought out that consolidated procurement should be regulated so as to achieve financial savings, on the one hand, and certainty, on the other hand. He did not specify what kind of certainty he had in mind, but assured that financial savings would be gained from bulk buying (Stenograph of the Riigikogu, June 20, 2000). In a later reading of the same draft he emphasised that the aim of consolidated public procurement was to simplify the procedures for both contracting authorities and suppliers (Stenograph of the Riigikogu, September 13, 2000). In looking at the consistency of the consolidated procurement with the general goals of public procurement set out by the legislature itself, it should be noted that in spite of setting the goal of encouraging new entrants to the market, it was not discussed whether consolidated procurement may in fact undermine this goal by giving advantages to larger and established firms.

The provisions concerning consolidated procurement stipulated that the Government (i.e., the Cabinet) would approve the list of the objects for which consolidated public procurement is applied, and establish the bodies responsible for organising consolidated procurement. Furthermore, it was set out that the Cabinet had the right to make it compulsory for government agencies to organise a tendering procedure through a specified organiser of consolidated procurement.

The Government Regulation No. 256 adopted on July 24, 2001 listed the objects, for which procurement would be consolidated, including cars, office supplies, and phone and Internet services. The regulation stated that the organisers of the consolidated procurements are the State Info-communication Foundation (SIF) for phone, data transmission and Internet services, and the Public Procurement Centre for the rest. The regulation was supposed to come into force January 1, 2002. However, with the subsequent

government regulations, the enactment of the regulation concerning *compulsory* consolidated procurement was postponed first until July 1, 2002, then until January 1, 2003 and then until January 2004. In spite of the postponement of compulsory consolidated procurement, the organisers of consolidated procurement started operating and carried out procurements for the listed objects.

In establishing the Centre of Public Procurement, the aims of consolidated procurement were more brought out by Maarika P里斯ke (the Chancellor of the Ministry of Economic Affairs) who emphasised transparency and saving money. She hoped that the Public Procurement Centre would provide quality service in organising the procurement (Eesti Teadeteagentuur, 2001). According to her, the consolidated procurement could help to prevent cases where the thresholds stipulated in the Public Procurement Act would be defied. At the same time, however, no prognosis was made how large the savings from consolidated procurement would be (Rumessen, 2001). The Government Order of December 12, 2000 established the State Info-communication Foundation. With the establishment of SIF, it was hoped that the communication costs would be reduced by 30% (Kärssin, 2000).

Thus, the main goals of consolidated procurement were to achieve financial savings as a result of bulk buying and to enhance the transparency of public procurement. These goals, however, were for most part not achieved as can be seen from problems that arose in the consolidated procurement of petrol and phone services.

The consolidated procurement for petrol in spring 2002 brought out some of the problems involved in centralised procurement. Because of the volume of the procurement, it turned out that without prior agreements between the tenderers, no single tenderer would have been able to participate in the tendering procedure. Thus, the conditions of the procurement would have led the tenderers to violate the Competition Act, which prohibits sharing the market and fixing prices (Oll, 2002). Consequently, the consolidated procurement for petrol was cancelled. Given that one of the general goals of the Act was to encourage new entrants, more attention should have been paid to how the Act in fact influences competition.

As for the consolidated procurement for phone-services, the State Info-communication Foundation carried out a consolidated procurement in spring 2001. As a result of the procurement, SIF was



able to lower the prices of phone services available to state agencies for half a year. However, after making cost-based calculations – and taking into account the actual costs of operating the services and the running costs of SIF – the prices were increased again in January 2002, leading to price-levels that were not significantly lower from those offered by private operators (Kagge, 2002b). Subsequently, several state agencies cancelled the services offered by SIF and started organising their own procurement procedures in order to find cheaper services (Kagge, 2002a). If the consolidated procurement of phone and Internet services had become compulsory, several problems would have arisen. Not all the state organisations have similar needs in terms of what kind of phone services they need. The combinations of necessary services might be quite different for different entities, thus giving rise to a situation where they may be better off organising their own procurement that would allow them to negotiate more optimal arrangements with the service-providers.

Thus, the consolidated procurement for communication services did not result in considerable savings in money because of the added operating costs of SIF. As for the consolidated procurement for fuel or office supplies, even if the savings in money had been possible, it would have had a clear effect of discouraging competition. With the amendments made to the Public Procurement Act in November 2003, the Parliament abolished the stipulations regarding consolidated procurement.<sup>8</sup> The Centre of Public Procurement and the State Info-communication Foundation were dissolved.

## DISCUSSION

As can be seen from the case study of the Estonian Public Procurement Act, the concerns of agency (i.e., preventing the purchasing authorities from defying the Act by dividing the objects of purchase into smaller parts) dominated the reasoning behind the lowering of the value thresholds, and the provisions on consolidated procurement sought to lower the transaction costs. With regard to the changes made to the tendering procedures, there was an attempt to balance the principles of lowering transaction costs and monitoring the agents, but due to the interaction of different provisions the control over the agents was clearly weakened. On the whole, in introducing these particular provisions, inadequate attention was

paid to how to balance the goal of transparency and economical use of money when they come into conflict.

Regarding the effects of the changes, for most part, the set goals were not achieved. Lowering the value thresholds of procurements did not prevent the purchasing authorities from dividing the objects of procurement into parts because of the ambiguous regulation of what objects can be procured together and because of insufficient control over the procurement activities of the agencies. Furthermore, the lowered threshold values worked against the general goal of economical use of resources by increasing the number of procurements and the administrative costs involved. The goal of promoting the use of open bidding procedures and reducing the number of procurements from a single source was also not achieved. The percentage of the least competitive tendering mechanism increased while the use of open tendering decreased. This may have had a positive side effect of decreasing the administrative costs of procurement by allowing the contracting authorities to opt for a cheaper procedure. On the other hand, however, the changes did certainly not achieve the goal of increasing transparency and control over the use of single source procurement since the Act did not provide sufficient venues for the Public Procurement Office or potential tenderers to dispute the use of this procedure. The main goal of consolidated procurement was to achieve financial savings resulting from purchasing larger volumes. Although the State Information Foundation was able to lower the prices of phone services for half a year, prices were then increased again. The Centre of Public Procurement, however, had to cancel the procurement for fuel due to the anti-competitive effect it would have had. Given the unexpected negative effects of these provisions, in November 2003 the Parliament increased the value thresholds, abolished consolidated procurement and reduced the number of conditions for which the least competitive tendering procedure can be used.

The case study of the Estonian Public Procurement Act exemplifies the general problems of administrative reforms in Estonia and other transition countries. As Temmes, Peters and Sootla (2004, p. 3) emphasise, the changes in the governance of the transition society is “a multidimensional task in which the government must govern both social complexity and rapid change” in managing the pressures between new models from a liberal democracy and a modern market economy and the old models of Communist regime.

This was certainly the case with the public procurement reform in Estonia where the challenge was to take into account the changing conditions and structures in the domestic market, the administrative capacities and the international requirements.

Temmes, Peters & Sootla (2004) also point out that the problems involved in reforms of public administration in Estonia are typical of such reforms in other transition countries in Central and Eastern Europe, including insufficient institutional arrangements and expertise levels, lacking political and technocratic support, and imbalance between political and technocratic values. Often, the domination of the short-run political targeting has undermined a cumulative and sustainable development of the administrative practices. These problems also came to the fore in the domain of public procurement. As could be seen in the case of lowering the threshold levels, it was primarily carried by the political value of enhancing transparency, without sufficient attention paid to the increases in the administrative burdens this would imply. Also, in the case of consolidated procurement, the expected cost savings were mere speculations and not supported by thorough analysis that would have included the operating costs of the special agencies created for carrying out the consolidated procurements. Furthermore, no expert analysis of the effects of the consolidated procurement on competition was conducted beforehand. Thus, given the lacking expertise and analysis, Estonia had to learn some lessons in public procurement by the trial and error method.

As in other Central and Eastern European countries, partly due to the enduring memories of Soviet administration and partly due to several scandals of corruption during the independent period, the trust of the government on the part of the Estonian population has been relatively low. This was also reflected in the attempts to make the procurements more transparent and was one of the reasons why the Irish model – where the domestic value thresholds coincide with the international thresholds – was rejected.

The problems Nemec (2001) has discussed with regard to competitive contracting in CEE countries have also been highlighted by the Estonian public procurement reform, in particular in the case of consolidated procurement. As Nemec points out, many of the potentially competitive markets are still not well developed in the Central and Eastern European countries and many partial markets

are still characterised by oligopolist structures that would in turn hinder the supply of competitive and effective bids.

Tõnisson (2005) points out that in the case of administrative reforms in Estonia, like in many other transition countries, the focus has often been on the question of “how?” rather than “why?” In the case of public procurement, the question of “why?” did receive some attention and the goals of the reform were discussed both in the legislative arena and in the media, but the goals seemed to be in constant flux, with priorities changing with the changes in leadership or in the political discourse. Also, the process suffered from inadequate attention paid to the end-goals.

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#### NOTES

1. Friedman (1989), for example suggests that law and economics covers three different enterprises: the use of economics to discover the effect of laws, use of economics to explain what the laws are, and recommendations of what the laws should be. Other categorisations of the approaches of law and economics are provided, for instance, by Hirsch (1988), Mercurio and Medema (1997), Klevorick (1975), and Katz (1998).
2. Regarding the theory of law, the approach of law and economics is often contrasted with the “imperative theory” which holds that most people do what the law requires, especially if the penalties for nonconformity are sufficient (Cooter, 1989) or as Richard Posner (1986) has put it, in the narrow sense, laws can be looked upon as commands backed up by the coercive power of the state. Thus, doctrinal research does not pay particular attention to how people respond to legal rules, nor to the policy issues raised by law (Ulen 1997). Law and economics, however, holds an incentive theory of law – law is seen as an incentive structure designed to achieve given ends (Ostas, 1998). The system of incentives, itself, however, is seen as containing implicit prices (Mattei, Antonioli &

Rossato, 2000). In other words, rules are understood as a system of rewards and penalties that affect individual behaviour (Kitch, 1983).

3. In the preliminary draft of a new Public Procurement Act prepared by the Ministry of Finance at the beginning of 2006, the goals of the act have been re-introduced again. It is stated that the goal of the act is to guarantee a transparent, rational and economical use of the resources of the procurer, to ensure equal treatment of persons and use effectively the existing competitive conditions.
4. Bovis (1998), for example, makes an important argument in looking at the trade-off between transparency and openness in public purchasing, and long-term savings and value for money considerations. He argues that price competition, as a result of awareness of public contracts, represents a rather static effect in the value for money process. The fact that more and more interested suppliers are aware and submit tenders, in the long run, appears rather as a burden in the form of administrative costs of tender evaluation and replies to unsuccessful tenders.
5. In addition, the economic importance of the SMEs in the market could be attributed to their ability to increase efficiency and enhance macro-economic growth, promote industrial restructuring and adjustment, create the opportunity for industrial and sectoral exploitation of particular skills and advantages, facilitate better allocation of resources and more equal income distribution (Bovis, 1998).
6. In the preliminary draft of a new Public Procurement Act prepared by the Ministry of Finance at the beginning of 2006, the value thresholds are proposed to be increased even further, to 40,000 euros for goods and services, and to 250,000 euros for construction contracts.
7. Open tendering was a tendering procedure where all interested parties could submit a tender; at two-stage tendering all tenderers submitted the general framework of a tender without price specifications in the first stage and the contracting authority invited the tenderers selected to submit final tenders together with price specifications in the second stage; negotiated limited tendering was a tendering procedure where the contracting authority negotiated with previously selected tenderers if the

necessary conditions existed; single source public procurement was a procedure where the contracting authority invited only one tenderer to the tender.

8. In the preliminary draft of the new Public Procurement Act prepared by the Ministry of Finance at the beginning of 2006, the option of consolidated procurement is introduced again. Whether this will gain the approval of the other Ministries, the Cabinet and the Parliament, is yet to be seen.

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