

**Intergovernmental Group of Experts on Competition Law and Policy**

**Geneva, 9-11 July 2012**

**Roundtable on**

**“Competition Policy and Public Procurement”**

**Written contribution by**

**China**

# **The status and prospect of Chinese public procurement system—— from the perspective of competition law**

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## **I. Chinese public procurement system**

### 1. The general situation

The scale of Chinese government procurement is increasingly expanding as the national government procurement has increased from ¥ 292.8 billion(2005) to ¥ 842.2 billion(2010) with an average annual growth rate of 23.5 per cent. Among that, the scale of centralized procurement has gradually increased so that further highlights its predominant position. The national government centralized procurement has increased from ¥ 235.9 billion( 2005 )to ¥ 728.4 billion(2010) as its proportion of the gross procurement has increased from 80.6% to 86.5%. The items of government procurement has extended from traditional goods procurement to construction procurement and service procurement.

In accordance with China's long-standing fragmentation of political and economic regulatory system, Chinese government procurement system on the one hand consists of two parts, the central and the local, each supervised by the central government and local government. On the other hand, in some regulated industries (such as railway, customs, bank,

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etc) the government procurement is operating a vertical intra-industry regulatory system.

## 2. Legal system

Government procurement legal framework with the "Government Procurement Law" as its core has basically taken shape in China. Besides "Government Procurement Law", there are "Budget Law", "Bidding and Bid Law", "Regulation on the Implementation of Bidding and Bid Law", "Interim Provisions on the Prohibition of Collusive Bidding Behavior" and departmental rules, etc. The draft of "Regulation on the Implementation of Government Procurement Law" was listed as a key legislative program in 2011 by The State Council as it has been revised for several times and opened to the public for comments, but has not been enacted so far.

In legal theoretical circle and practical circle, government procurement law is considered as budget law by most people as its purpose is using financial fund economically, so that government procurement law and competition law belong to different areas of economic law. There is no direct stipulation about government procurement in Chinese "Antimonopoly Law", the only stipulation about government procurement is Antimonopoly law: "Article 34 Administrative agencies and organization empowered by laws and

regulations with competence to manage public affairs cannot abuse their administrative powers, by setting up discriminative qualification requirements, judgment criteria, or publication of information not subjected to law, etc., to eliminate or restrict foreign undertakings in participation in local tendering and bidding activities." Actually, this article just prohibited government procurement behavior with Regional Protectionism, which is treated as administrative monopoly. Except that, there is no regulation on other types of government procurement behavior in competition law.

### 3. Subject of the public procurement

In China, public procurement is limited to government procurement.

According to "Government Procurement Law"(came into effect in 2003), article 2:"Government Procurement'refers to the purchasing activities conducted with fiscal funds by government departments, institutions and public organizations at all levels, where the goods, construction and services concerned are in the centralized procurement catalogue compiled in accordance with law or the value of the goods, construction or services exceeds the respective prescribed procurement thresholds." So "procuring entity" includes state organs, public institutions and organizations.

"Government Procurement Law" shall not apply to state-owned enterprises as it isn't included by the "procuring entity" which is stipulated in "Government Procurement Law". This definition( "procuring entity" ) is different from those stipulated by western countries. Besides "central government", "government procuring entity" stipulated by GPA( Government procurement Agreement) includes "non-central government entity". For example, in the United States, "non-central government entity" includes Federal Deposit Insurance Corporation, Overseas Private Investment Corporation, National Community Service Corporation, Export-Import Bank, Federal Home Loan Mortgage Corporation, Uranium Enrichment Corporation, Federal Crop Insurance Corporation,etc. These central-level corporations don't belong to the federal government but can be directly controlled or influenced by the federal government. Another example is that the German law divides "public procuring entity" into two categories: traditional public procuring entity and public corporation(Sektorenauftraggeber). So in the process of China's applying for GPA, a big disagreement arose between China and other countries towards the issue whether state-owned enterprises should belong to "procuring entity"(GPA). In addition, in the ongoing negotiation, the United States and Europe also made clear that sub-central government entity should belong to "procuring entity"(GPA).

#### 4. Supervision and regulation of the PP

According to "Regulation on the Implementation of the Bidding Law" article 4: "The development and reform department of the State Council shall guide and supervise the bidding work across the country and supervise and inspect the bidding activities for the state's major construction projects.

The departments of industry and information technology(MIT), housing and urban-rural development(MOHURD), transport(MOT), railways(MOR), water resources(MWR) and commerce(MOFCOM) of the State Council shall supervise the relevant bidding activities according to the prescribed division of functions.

The development and reform department of the local people's government at or above the county level shall guide and coordinate the bidding work of its administrative region. The relevant departments of the local people's government at or above the county level shall, according to the prescribed division of functions, supervise bidding activities, and legally investigate and deal with violations in bidding activities. Where the local people's government at or above the county level otherwise prescribes for the division of supervisory functions of its subordinate departments on the relevant bidding activities, such provisions shall prevail.

The public finance department shall, according to law, supervise the budgetary performance and the implementation of government procurement policies on government procurement construction projects that are subject to bidding.

The supervisory organ shall, according to law, supervise the relevant supervisory objects relevant to bidding activities."

But now problems of government procurement supervision system are outstanding.

a. Self-supervision based, weak at external supervision

According to the law, the supervision system is dissociated as all local people's governments are supervising their own procurement, MOR(mentioned above) is supervising railway system's procurement, MIT is supervising the procurement of electronic information products and MOHURD is supervising the procurement of construction projects. These departments are operating a self-supervision system as they are both the procuring entities and the supervisors. When faced with disputes, these departments can't resolve disputes objectively.

b. Fragmentation of supervision system , in lack of unified supervision system

Each supervision system goes its own way as there is no national unified supervision system or supervision standard. In addition, the

government is in absence of an unified system which can review qualification of suppliers effectively.

c. In lack competitive supervision

As most people think that government procurement law and competition law belong to different areas of economic law, competition administrative departments are not authorized to regulate government procurement behavior. From August,2008(when "Antimonopoly Law" came into effect) to now, competition administrative departments haven't intervene in any government procurement cases that might violate "Antimonopoly Law" or "Anti-unfair-competition Law". Although in practical, anti-competition behaviors are the most common and outstanding violations in government procurement.

d. In absence of right relief system

Under the current law, government procurement can only be supervised or inspected by administrative organs, any other relevant parties can claim no right to violations. These stipulations aren't helpful for protecting lawful rights nor give full play to the initiative of the private in law enforcement.



## **II. Prominent issues of public procurement in practice: Illegal procurement behavior restrict competition seriously**

According to the materials presented in the website of government procurement information<sup>1</sup>, the vast majority of government procurement disputes were caused by anti-competition behaviors which were done one or more parties of procuring entity, entrusted procuring agency and supplier. Among these, the most common behaviors are listed below: tenders prevent non-local enterprises, small and medium enterprises from taking part in government procurement through unreasonably setting tender threshold in tender document; tenders apply discrimination treatment to disadvantaged groups (such as unincorporated enterprises, newly-founded enterprises) to prevent potential-suppliers from taking part in government procurement through unreasonably setting tender threshold in tender document; malicious collusion between suppliers or between supplier and entrusted procuring agency; rent-seeking behaviors of government.

Reasons for these illegal acts are local protectionism and prevalence of the prerogative of state-owned enterprises, especially large state-owned enterprises. The current fragmentation of the government procurement

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<sup>1</sup> <http://www.ccg.gov.cn/zcfg/>

<http://www.caigou2003.com/theory/case/list-page-2.html>

system, which lacks of unified national regulatory agencies, systems and standards, does not yet construct a system condition to break local protectionism and the privilege of state-owned enterprises .

Another reason is the supervision on different kinds of malicious collusion is mainly limited to administrative supervision which is selective and self-monitored. So the supervision on malicious collusion more or less done by procuring entity is unsurprisingly weak.

In addition, relative weak legal punishment(or low cost of violation) is also the reason why collusive bidding behaviors are so rampant. For example, according to "Bid and Bidding Law" article50-53:"If a bid invitation agency violates this Law, it shall be imposed a fine of not less than 50,000 yuan nor more than 250,000 yuan", "If the bid inviting party violates this Law, it shall be ordered to make amends and may be imposed a fine of not less than 10,000 yuan nor more than 50,000 yuan", "If a bidder colludes with one or more other bidders or with the bid inviting party in the submission of its bid, or if a bidder seeks to win the project by offering a bribe to the bid inviting party or one or more of the members of the bid evaluation committee, the acceptance of its bid shall be void, the bidder shall be imposed a fine of not less than 0.5% nor more than 1% of the amount of the project which it won and the persons in charge directly responsible; if the circumstances are serious, the bidder's bidding qualifications for projects which legally require the invitation of

bids shall be suspended for one to two years". There is no wonder why the violations are so rampant as the cost of violations is low while the "profit" of the violations is high. So we must take severe legal measures to punish collusive bidding behaviors so that they will not only lose their "profit", but also their bidding qualifications.

Last but not least, the current legal system is in absence of right relief system. Under the current law, victims can't claim for compensation, institute an administrative proceeding or submit a legal review. Law enforcement falls to the ground as the administrative department is weak and nonfeasance.

**. Thorny issues for public procurement law: coordination of competition target and other policy goal**

China traditionally emphasizes public procurement must comply with law and policy and public procurement fund must be used legally and efficiently which leads Treasury Department's core role in public procurement. In recent years, our country attaches more importance to political function of public procurement. "the Eleventh Five-Year Plan for National Economic and Social Development" explicitly made government procurement an important tool for national macroeconomic regulatory and required political function of government procurement be expanded and enhanced. Government procurement has promoted energy

conservation ,emission reduction and environmental protection, boosted use of genuine software and intellectual property protection and supported relevant domestic industries and so on. Article 9 of “Public Procurement” stipulates that government procurement shall be conducted in such a manner as to facilitate achievement of the goals designed by Sate policies for economic and social development, including but not limited to environmental protection, assistance to underdeveloped of ethnic minority areas, and promotion of the growth of small and medium-sized enterprise. But there is few specific rule when it comes down to market order which has the most influence to government procurement. Not only in lawmaking but also in practice and academic community, there isn't enough concern and discussion concerning competition target and other policy goal and their direct relation.

Take procurement market of industrial communication device as an example, current law stresses Treasury Department supervise implement of procurement budget and procurement policy, at the same time authorizes Industry and Information Department to inspect bidding and bid activities, but does not require or authorize any organization from neutral and professional standpoint to maintain public procurement order.

Government procurement behavior has both government behavior character and market behavior character. Thus, government procurement behavior regulation is administrative and only combine with market

behavior regulation can supervisory capability and productiveness of government procurement be improved. Therefore, there are two kinds of intervention, i.e, competitiveness intervention and other policy intervention. It is necessary to make clear their respective objective and whether invention is appropriate in the situation and that competitiveness intervention domines. Also, it is needed to strengthen information exchange system and opinion interchange system between two supervision and inspection organizations and promote these two organizations' collaboration.

**. Enhance competition in public procurement**

1. Budget law approach and competition law approach

a. Budget law approach and its defect

Public procurement has been traditionally thought as a part of treasury and budget law. Not only in China but also in the west, it has been enforced as treasury and budget law for a long time. The budget law approach has three deadly defeat. Fist,if a public procuring entity violates obligation and causes a bidder's damage, he/she only need to take administrative responsibility but not compensation liability to the bidder. So there is no relief right for the bidder and he has no right to ask for the public procuring to comply with related law. Second, though the law authorize some administrations supervise and inspect law enforcement

and industry action, the effect is far from good due to self-supervision and lack of efficiency independent supervision mechanism. Finally, the most direct influential part ——market competition order has not been regulated by law.

b. Competition law approach: bring in and protect competition;investigate competition law responsibility , better legal remedy

In Europe, competition approach grew up along with public procurement law reformation in 80s and 90s of the last century in which European Community demands protect bidders from procuring entity's behavior's damage. The approach keeps bidding and bid of public procurement in the overall framework of maintaining free competition and fair competition and stresses that in bidding and bid process, the principle of as fully as possible competition should be implemented. Hence, bidding and bid law is a part of competition law. Competition approach not only conforms to the fundamental objective of bringing in and enforcing competition, but also effectively eliminate two defects of budget approach in which bidders do not have independent and legal remedies to tenders, also the judiciary has no judicial review on the bidding behaviors and procedures. As competition law provides effective supervision, inspection and punishment mechanism, the party damaged by illegal act also can sue injurer for compensation for damage and ask

the Court review the government procurement on the basis of competition law.

In competition law approach, formulating the Bidding and Bid Law have several legislation patterns which includes making public procurement a part of competition law like Germany's model and establishing independent bidding and bid law. But with a view to give bidders actio and authorize the Court the power of effective, independent and authoritative judicial review, it is necessary to reinforce the link and ensure conformity between competition law and bidding and bid law of government procurement.

## 2. competition advocacy and more effective public procurement

In competition approach, competition advocacy is conducive to resolving the difficulties faced by Chinese government procurement law and practice and improves fairness and efficiency of government procurement. Competition advocacy mainly includes: counsel before competition legislation ,when drafting government procurement and correlative rules,competition supervision and inspection department should make sure the compatibility and coherence between the law and market competition require so that interacting relation between government procurement and market competition order can be preserved.

### a. Enhance the function of competition authority

In addition to the director of treasury and budget department and

industry department, competition authority should be clearly an core supervision and inspection institution of government procurement. Treasury and Budget Department taking charge of budget executing.

b. Competition Institution being in charge of market competition regulatory and Environmental Protection Department, the Ministry of Science and Technology, SME Promotion Ministry which are all responsible for policy-oriented supervision consist of the whole government procurement supervision and inspection system. Furthermore, it demands that supervision system be integrated so as to ensure every department do their own job in accordance with division of work. Especially importance is to build up and solidify the supervision structure in which administration separates procurement. In these ways can we get both thorough government procurement supervision system and duty-oriented administration system. Self-control in supervision and inspection should be lessened and independence and authoritative of competition regulatory system should be augmented.

Management style should change from focusing on administrative supervision means to using market mechanisms. Because of administrative and marketable characteristics of government procurement, on the one hand, we should continue to improve the administrative supervision means and put multi-department coalition including Treasury Department, Auditing Bureau and Supervision Institution into fully use,



on the other hand, we should make greater efforts in promoting competition, clarifying confusing rules, making information public and propelling integrity.

c. Strengthen competitive of procurement process assessment.

Reduce the market access of procurement market

Unite public procurement market and its standards and assessment to break regional protectionism.

With the accelerated process of China's accession to the GPA negotiations and GPA members' increased focus, it is necessary to keep continue carrying out policy function, government procurement, and at the same time

d. Play a proper function of government procurement in Opening to the Outside

In the background of global economy, to occupy a spot in international market, Chinese enterprises must sharpen itself in global competition. It is an inevitable trend for China to join in GPA. To face with our country's accession, it is not only needed that market oriented function of government procurement be emphasized and developed which covers supporting MSE, encouraging technology innovation, promoting energy conservation and emission reducing, but also adaptability to outside competition of China's public government law be strengthened. After all, only through aiming at competition concept, improving the

understanding and adaptability to international procurement rules can we formulate our own government procurement law and policy accord with international rules and as well embodying Chinese characteristic.

Regard to whether Chinese state-owned enterprises should be public procurement entity, inland government procurement law has jurisdiction over state-owned enterprises according to international standard rules, but GPA AGREEMENT signed in 1994 and revised version in 2006 has no rule about this matter. The judge standard has been changed from government control or impact to entity in initial version to government control or impact to procurement activities in revised version. Therefore, state-owned enterprises for purely commercial purposes of procurement should not be treated as government procurement behavior, but for the purpose of government consumption, the use of budget should not be. Unlike relative small number of state-owned enterprises in Western countries but controlled by government, the number of Chinese state-owned enterprises is big but there are actually true sense of market players or at least in the process of transformation to market body. Hence, to consider all Chinese state-owned enterprises as government enterprises and make them public procurement entities violates the objective process of reform as well as with Western countries' request Chinese state-owned enterprises be reformed into market economy entity. We suggest that make a distinction between competing industries and non-competitive

industries and non-competitive industry's procurement activities influenced or controlled by government can be applicable to the Government Procurement Law.

### . **Outlook**

Many developing countries want to integrate into the world trading system with the help of GPA and at the same time Western countries are eager that leading power of developing countries open up their public procurement markets. China is the first developing country to apply for GPA. Apparently there is a big gap between the GPA members' expectations of open market and the economy status of developing countries. With China's accession to the GPA negotiation process is accelerating, China's public procurement legal system and policy practice are faced with new challenges.

There are two things occurring recently without foreign reports. They boost our confidence in bringing in competition and establishing fair and reasonable procurement basic principles. The "guidance on promoting water conservancy construction projects bidding and bid to enter public resource trading market" issued by the leading office of central governance on Handling of salient problem in construction area and Ministry of Water Resources on May 8th 2012 requires government invested and state funds invested water conservancy construction bidding and bid activities demanded by law all should enter an unified and

standard public resources market before July 1st 2013. This helps enhance the fundamental role of market allocation of public resources and regulate bidding and bid activities of water conservancy construction project and prevent corruption from the source.

It is followed by “guidance on railway projects bidding and bid on local public resources trading markets”, which is issued by the leading office of central governance on Handling of salient problem in construction area and the Ministry of Railways on May 12 2012. The guidance abolishes railway construction trading centers originally owned by Ministry of Railways and 18 railway bureaus (companies). Also it demands railway construction bidding proceed within the unified public resources trading market in the future. Engineering projects managed by 18 railway bureaus should enter into local public resource trading markets to bid respectively at the end of May and end of June this year. Related practicable implementation has not been public.