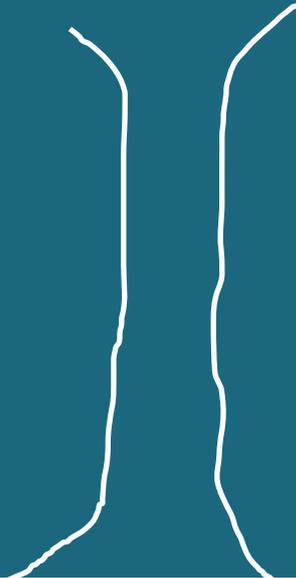


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**IMPROVING TRANSPARENCY
AND GOVERNANCE
OF PUBLIC FUNDS
PUBLIC PROCUREMENT
PROCESS IN KOSOVO**



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IMPROVING TRANSPARENCY AND GOVERNANCE OF PUBLIC FUNDS PUBLIC PROCUREMENT PROCESS IN KOSOVO

August, 2012

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Disclaimer:

The views expressed in this report are those of the authors and do not necessarily represent those of the CIPE.



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Improving Transparency and Governance of public funds-public procurement process in Kosovo

This study is an analysis of the challenges towards reforming public procurement system in Kosovo and the shortcomings in the implementation of the law. Riinvest Institute with the support of Center for International Private Enterprise (CIPE) has launched a comprehensive analysis which covers the most important dimensions of this process. This study solicits the views of all relevant stakeholders including among others: the central procurement institutions, parliament, government, private sector, civil society and media. Public procurement makes up close to one fifth of Kosovo's GDP and thus is one of the major drivers of its economy. Therefore, it must be done efficiently and transparently in order to provide a level playing field for all actors involved and help government to get the best value for taxpayers' money. Public procurement process in Kosovo has marked evident advancements, especially in the legal and institutional infrastructure, however the implementation of the law remains a big challenge. The public procurement in Kosovo, from the majority of actors involved in our research, is perceived to have been tainted by corruption. Therefore it is recommended that institutions and mechanisms that ensure the integrity of this process are strengthened.

Riinvest is committed to play an active role in publicizing the importance of a sound public procurement which promotes fairness, efficiency and minimization of corruption and misuse of taxpayers' money while it maximizes the economic and social gains of public procurement. We would like to thank CIPE very much for supporting this research and related activities and for their continued cooperation during the realization of this project. We would like also to thank managers and business representatives, official of the institutions, representatives of media and civil society for their cooperation during the implementation of our research. Riinvest wishes to thank all parties involved in preparation of this report for their contribution while it assumes the sole responsibility for findings and conclusions of the report.

Prishtina, 2012

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Abbreviations

| | |
|----------------------|--|
| BIRN | Balkan Investigative Reporting Network |
| CG | Corporate Governance |
| CIPE | Center for International Private Enterprises |
| CPA | Central Procurement Agency |
| EC | European Commission |
| e-procurement | Electronic Procurement |
| EU | European Union |
| EULEX | The European Union Rule of Law Mission in Kosovo |
| GDP | Gross Domestic Product |
| KEK | Kosovo Electric Corporation |
| KIPA | Kosovo Institute of Public Administration |
| MEAT | Most Economically Advantageous Tender |
| MP | Member of Parliament |
| NGOs | Non-Governmental Organizations |
| OECD | The Organisation for Economic Co-operation and Development |
| POEs | Publicly Owned Enterprises |
| PPA | Public Procurement Agency |
| PPL | Public Procurement Law |
| PPRC | Public Procurement Regulatory Commission |
| PRB | Procurement Review Body |
| USAID | United States Agency for International Development |

Executive summary

This study is an analysis of the challenges towards reforming public procurement system in Kosovo and the shortcomings in the implementation of the law. Using primary and secondary data it reviews the forwards and backwards in the process of establishing this system. It solicits the views of all relevant stakeholders including among others: the central procurement institutions, parliament, government, private sector, civil society and media. Research results suggest that, despite evident advancements in this field, a lot remains to be done in the future especially in ensuring proper implementation of legal provisions. Public procurement makes up close to one fifth of Kosovo's Gross Domestic Product (GDP) and thus is one of the major drivers of its economy. Therefore, it must be done efficiently and transparently in order to provide a level playing field for all actors involved and help governments to get the best value for taxpayers' money. The public procurement process in a country is an essential determinant of the success of promoting competition and private sector development, strongly influencing economic growth, job creation and standard of living. Therefore reforms that aim at the development of transparent and accountable public procurement process which encourages competition, efficiency and sustainability of companies should be high up in the priority list of governments.

As a transition country, Kosovo started in 1999 to build its new institutions that will facilitate a market-led economy. However, this process started later than elsewhere in Eastern Europe following a decade of emergency ruling and a devastating war. Part of the transition course was the process of introducing public procurement process and practices. As such, the public procurement system in Kosovo is very recent. The International Community made its first attempt at introducing public procurement as early as 1999, but the first Public Procurement Law (PPL) with the involvement of the Provisional Self Governing Institutions was only brought up in 2004. While this legal framework marked evident advancement in the field, it still proved inefficient and not in line with European Union (EU) directives on public procurement. Similarly, the implementation proved very difficult and incurred higher costs for the Kosovo Consolidated Budget.

The new version of the law was promulgated in June 2007. It aimed at increasing the alignment of the legal framework with the EU directives. It established the institutional structures for public procurement including the central procurement institutions. In 2010 the new law was presented by the government to the assembly. Even though that the process of drafting new legislation was highly supported by EU technical assistance,

the input from this expertise was not reflected in the presented law. Accordingly the findings of the European Commission (EC) were that the new law diverged significantly from the EU directives. This law contained a number of provisions that exposed procurement officers to political interference and pressure, and thus undermining the transparency and accountability of the overall process and opening up opportunities for corruption (EC, 2011). This version of the law remained in force for only 10 months until it was changed during 2011. The current version is mainly in line with European standards; however Kosovo still needs to improve the legal framework in the public procurement area while the amending process should be more comprehensive internalizing the input from other relevant stakeholders.

Some of **key findings** from our research include:

-On the legislative segment:

- The public procurement system in Kosovo has achieved considerable progress despite being very new. In spite of the inception challenges it was able to draw from experiences of other countries and enjoy the technical support of many international experts who were engaged in this process.
- Despite its controversy in 2010, the current legislation is mainly in accordance with directive of the EU.
- The secondary legislation is largely completed but complicated.
- Another advancement put forth in the last set of legislative changes was to put an end to the obligation that contracting authorities had to publish the announcements in the national newspapers. The benefits are felt in several directions. First, it saves taxpayers' money; secondly it will be easier for the contracting authorities to follow the announcements in centralized internet portal and finally it lowers the dependence of media on government money who in turn interfere in their editorial policy.
- The current legislation provides that apart from public procurement officials in the contracting authorities, the contracts have to be signed also from their administrative and political superiors. This step was considered positive given that it increases the responsibility of the political representatives. However, the share of responsibility is only limited to large value contracts.
- Public procurement law is not suitable for companies operating in competitive markets. Public enterprises complain

that the implementation of procurement procedures is very cumbersome so that it lowers the competitive power of these enterprises.

- The current legal framework allows taking e-procurement into effect. Currently the process of the e-procurement infrastructure is at its inception phase with the support of international donors (including World Bank and USAID) under the auspices of central procurement institutions, most notably the PPRC. It is expected that 2013 will mark the real testing phase for e-procurement.

-On procurement activities in Kosovo:

- Public procurement activities represent a significant share of Kosovo's GDP.
- The use of framework contracts and centralized procurements by contracting authorities has increased though not at satisfactory levels.
- Open procedures account for over 80 percent of total value of signed contracts.
- The level of single source tendering has decreased after reaching alarming levels in 2008 however it still remains at around 7 percent.
- As for the contract award criteria, lowest price criterion continues to dominate the overall value of total number of contracts. The remaining contracts are awarded based on most economically advantageous tender (MEAT) criterion. Big concerns remain about the objectivity of contract award criteria.
- Level of competition in the procurement process has exhibited a slight decrease during the last year. The average number of companies bidding for a tender has dropped by around 13 percent. Our survey findings suggest that companies have started to lose trust in the process hence they are self-selective in bidding. They maintain that in a lot of cases the winner is known once the invitation for bid is published therefore they chose not to participate.
- The proportion of foreign economic operators winning public contracts has increased in recent years.
- There is high proportion of tenders that are cancelled. On average around 35 percent of contract notices are cancelled on different grounds. This gives rise to big concerns.
- The number of appeals that Procurement Review Body received during the last year has increased. Allegations made by the appealing parties are mainly oriented to violation

of legislation in force regarding Public Procurement, to decisions of Contracting Authorities during the evaluation process of the procurement activities and to award of contracts. Majority of them were approved (52 percent) or asked for re-valuation (29 percent). The remaining cases were re-tendered (19 percent).

-On the views of private sector and private sector representatives:

- Companies complain that tendering procedures and paperwork is very complicated and sometimes they get disqualified due to non-technical compliance with the requirements.
- Survey results suggest that the business environment is not conducive and the competitive advantages of companies are not based on efficiency and productivity; they are rather based on illegal and dishonest behaviors of certain companies. This business environment coupled with weak institutional capacities (especially in judiciary system), create a fruitful soil for corruption and other malfeasance practices to flourish.
- Results suggest that there is a high level of concentration in the public procurement in Kosovo and only a small fraction of companies are awarded contracts. Businesses maintain that the reason for this are mainly related to close connections that some companies have with the public officials.
- Majority of enterprises respond that the reason for not being awarded contracts rest on external factors (i.e. those outside the influence of the company; and government procurement practices are labeled as the main reason). However they also acknowledge that there are internal obstacles as well. The latter, are mainly related to producing an eligible offer.
- Results suggest that the lack of political will is the common denominator of all responses as being responsible for drawbacks and the lack of improvements in the public procurement process.
- Businesses suggest that the government is captured by companies and other interest groups who finance their political parties and back them financially in regular basis. The awarded contracts then serve as a payoff for such support (the 'grabbing hand' model of corruption). Businesses do not rule out cases in which it is only the public procurement officer that is corrupted (i.e. the government is benevolent and has innocent motives), but they suggest that these cases are mainly limited in small value contracts.

-On the views of public procurement officials:

- Public procurement officials maintain that PPL lacks flexibility and as a consequence they are forced to do small administrative violations. These violations in turn are used as an extorting tool by their administrative and political superiors.
- Public procurement officials maintain that because of their increased competences with the current legislation, the pressure on them has increased as well.
- As for the trainings of procurement practitioners, they are still considered to be very theoretical with no practical (case-study) approach. This is strongly maintained by public procurement officials that were interviewed.
- Public procurement is mostly treated as purely technical process with small degree of integration of procurement process into the overall public expenditure management.

-On the views of civil society and other informed stakeholders:

- Businesses and civil society organizations consider that there are no mechanisms in place that would ensure the integrity of the procurement process. There is a general feeling that procurement process and the spending of public money as a result is highly misused. This view is not shared by the governmental institutions as well as central procurement bodies.
- Majority of actors share the opinion that the working group in charge of legislative improvements on public procurement should be opened up so that it includes other stakeholders as well.

Policy recommendations:

For central procurement institutions:

- Although a great deal has been done in the last two years in terms of legislation, there is still considerable room for improvement, especially with regard to the institutional framework. Improvements should be made to ensure better compliance of the PPL with EU directive and good practice and to secure its solid anchorage among the key stakeholders. Any legislative change should be preceded by a constructive and comprehensive dialogue among the key stakeholders.
- The use of centralized procurements should be increased given that buying in bulk increases the value for money by improving price conditions.
- Address urgently (by the PPRC) the lack of secondary legislation and design advisory support to facilitate the application of the law by contracting entities and to increase the understanding of economic operators. PPRC should provide contracting authorities and suppliers with more detailed

written guidance to assist them in the practical application of the law. In coordination with KIPA, trainings should also be organized for suppliers.

- The process of establishing e-procurement and e-auction infrastructure should be fast-tracked. The expected savings from the implementation of the e-procurement system should be used to increase salaries of the public procurement officers as well as finance other development programs in this field.
- In an effort to address internal obstacles that companies face, respondents suggest that more training should be offered to private sectors either by KIPA or other independent institutions. Respondents (especially the business representatives) claim that they would welcome a toolkit which will be a step by step guide to preparing bids for government contracts.
- Increase the monitoring and overseeing capacities of PPRC, PRB and the General Auditor related to contract management and execution. They should have credible commitment to punish any misconduct in implementation of PPL.

For the government:

- Government should make efforts to improve the business environment so that it encourages the development of competition in the domestic market.
- A higher degree of integration of procurement process into the overall public expenditure management process is recommended.
- The rotation of officials involved in procurement process is recommended in those positions which are sensitive or involve long-term relations and where the number of companies competing is limited.
- Continue to support the capacity-building of the KIPA with the objective of developing a professional training system in public procurement. In this regards, continued efforts to improve the human capacities of contracting authorities are necessary to ensure professional handling of tenders.

For the donor community:

- Donor community should support research on this field. They should also support the establishment of a study program at the university level which will create a group of professionals in public procurement. The fees of this program can be partly subsidized by savings made after the implementation of e-procurement system.
- Greater support should be provided to central procurement institution to consolidate their operations through: (i) completing and simplifying secondary legislation; (ii) establishing full transparency and reporting procedures toward investors, public opinion, the government and parliament.

For the opposition parties and civil society organizations:

- Opposition parties should actively seek from the government to improve the public procurement system by increasing the public pressure.
- Civil society organizations and media should be more active in monitoring and signaling malfeasance in the public procurement process as well as come forth with recommendations on improving the system.

For the parliament:

- Parliament should be more active in holding the central procurement bodies as well as the government accountable for implementation of law. It should also engage other stakeholders in parliamentary hearings in future legislative amendments.
- Continue to support the capacity-building of the PRB, especially with regard to decisions on interim measures, and monitor compliance with the clarifications in the law concerning the PRB's functions.

Methodology

This report is based on primary and secondary data. Primary data included a survey of enterprises, case studies of firms in different economic sectors and interviews with relevant stakeholders (including Members of Parliament, Representatives of central procurement institutions and procurement practitioners, business associations, civil society organizations and media). The procurement process in Kosovo, up to now, was mainly approached by legal point of view and the views of the businesses were not reflected appropriately. What is more, there is no study analyzing jointly the view of all relevant stakeholders on the procurement process in Kosovo. This research therefore aims at filling this gap by evaluating the forwards and backwards in the setting up of the procurement system in Kosovo. For this purpose, the survey includes a sample of around 600 enterprises, which is a statistically representative sample for the enterprises population.¹ Sampling and survey implementation have followed standard surveying methodology. The data was gathered in face-to-face interviews with key people in firms - owners or managers – who are well-informed of the developments in the firm and authorized to provide the information. Likewise, interviews with other stakeholders were conducted by senior staff of the research team so as to minimize the risk of inconsistent interpretation. The questionnaire was designed to be used in soliciting views of all respondents though it was slightly modified in each case to reflect the specific background and position of the responded. The questionnaire consisted of two groups of questions: one group required the respondents to rank the extent of their agreement or disagreement with various statements on a five-point Likert scale. The other group consisted of open ended questions which aimed at soliciting more qualitative responses on the topics under consideration. For survey questionnaire refer to appendix 2 while for interview guideline refer to appendix 3. Apart from the primary data collected by the research team, this study also uses data obtained from national or international institutions.

We would like to thank CIPE very much for supporting this research and related activities and for their continued cooperation during the realization of this project. We would like also to thank managers, owners and other respondents for their cooperation during the implementation of survey and preparation of case studies. Riinvest wishes to thank all parties involved in preparation of this report for their contribution while it assumes the sole responsibility for findings and conclusions of the report.

¹ The data was gathered during the period: April – June 2011. The population of companies is around 45,000 while the sample size is 600. The confidence interval of the sample is 99 percent and the confidence level is 5 percent. The population of companies is around 45,000 while the sample size is 600.

Introduction

Kosovo is the last country in Europe to embark on the road of transition to a market economy. Its transition process started from a very difficult starting point. During the nineties, its economy had already suffered from poor economic policies, lack of domestic institutions, broken external trade and financial links, international sanctions, underinvestment and de-industrialization which culminated in a war at the end of the decade. After the war of 1999, with joint efforts with the international community significant improvements were achieved in terms of post-war reconstruction and the establishment of new institutions.² Part of this process was the endeavor of introducing public procurement system. Public procurement makes up close to one fifth of Kosovo's GDP and is one of the major drivers of its economy. Therefore, it must be done efficiently and transparently in order to provide a level playing field for all actors involved and help governments to get the best value for taxpayers' money. It is widely acceptable that a transparent public procurement is critical to achieving more efficient allocation of resources through increased competition, thus to this aim, systematic and continuous reforms are necessary.

Public procurement is the one of those activities that government undertakes that are most vulnerable to corruption (OECD, 2007). Public procurement process in Kosovo is very often perceived as being prone to corruption and its integrity is often put into question (Knopic, 2004; European Commission, various years; Riinvest, 2011). To inspect this segment in Kosovo, Riinvest with the support of CIPE has launched a comprehensive analysis which will cover the most important dimensions of this process. Our study solicits the views of all relevant stakeholders including: procurement practitioners in charge of designing, supervising and managing procurement processes in government institutions, members of competition authorities and anticorruption specialists have also been involved, civil society representatives, MPs, and private sector.

Problems in creating a sound public procurement system are ubiquitous and Kosovo is not an exception. This process proved particularly challenging for countries that have gone from centrally planned to market economies where the public procurement is a novelty. Public procurement in Kosovo is established after the 1999 war with the support of international community though currently it has a strong local authorship. The legal framework has been continuously improved and is now considered to be largely in accordance with the EU directive, though further improvements are required. Our research suggests that the overall weakness of the procurement system stems from the implementation of the law. This segment requires significant improvements in order to minimize the misuse of taxpayers' money as well as to restore distortions in the market.

This report is divided in four sections which are organized in the following way. The first section discusses the public procurement in general. It also reviews risks associated with each phase of public procurement procedures as well as corruption models in this process. The second section discusses the public procurement developments in Kosovo. There we analyze the chronological development of the procurement system followed by a review of procurement activities in Kosovo. The third section discusses the views of the businesses towards the public procurement in Kosovo. Drawing on findings of a representative sample it analyses different aspects of this process and the impact it has on promoting (or impeding) competition and efficiency. The fourth section reviews the views of other stakeholders which were interview specifically for the purpose of this research.

² After the war of 1999, Kosovo was governed by the United Nations Mission in Kosovo (UNMIK) according to the Security Council Resolution 1244. The Provisional Self Governing Institutions were established some years later while the declaration of Kosovo's independence was done in February 2008 by the democratically elected parliament.

SECTION 1

Preface

-What is public procurement?

Public procurement may refer to the actions carried out by the government for the purpose of purchasing goods and services which are needed for it to carry out its activities.³ The public procurement process is of considerable economic significance, accounting for an important proportion of countries' Gross Domestic Product (GDP). Procurement of goods, works and other services by public bodies alone amounts on average to between 15% and 30% of GDP in most of the countries while in some countries it accounts for even greater share (Olaya and Wiehen, 2006). On the other hand, public procurement has been identified as the government activity most vulnerable to corruption. As a major interface between the public and the private sectors, public procurement provides seemingly endless opportunities for both public and private actors to divert public funds for private gain (OECD, 2007).

Public procurement process involves several stages which can be broadly grouped into three phases: (i) identification of the needs and preparation of the procurement plan, (ii) the contracting process itself, and (iii) contract administration and implementation. The public procurement might refer to all three phases and their importance is jointly acknowledged and studied and is therefore considered as a cohesive process. There is an important relationship between these stages as there is danger that failing to complete one stage properly impacts the other phases and the whole process as a consequence. For instance, procurement process involves the need for planning carefully the future purchases leaving sufficient time in compliance with rules and regulations. Procurement law might allow for short-cut procedures in cases of urgencies but they are not allowed if the urgency was foreseeable. Similarly, strict regulation at the contracting phase might be undermined if there is no appropriate control and oversight in the implementation phase. If the latter stage is ineffectual, then fraudulent behavior might arise in implementing the contract. Thus a favored bidder in collusion with the procurement official can offer a very favorable bid to win the contract (following all procedures), but in turn will allow the winning bidder to compromise with the quality standards. Also, even if the procurement official is benevolent, the bidder

might offer very low price for it to be able to manipulate later by asking better terms.⁴ Changes made in the contract during this phase are inherently harder to monitor given that there are no other competing companies to control the process.

-Risks associated with public procurement and ways to promote efficient system

Much is written on the public procurement in general, demonstrating the complex nature of the topic. In particular, ample attention is dedicated to the integrity of the public procurement process and the risks that it faces in each phase. Table 1 summarizes the risk related to procurement process in pre-bidding, bidding and post-bidding phase.

TABLE 1. RISKS IN PUBLIC PROCUREMENT PROCESS

| Pre-bidding | Bidding | Post-bidding |
|---|--|--|
| <ul style="list-style-type: none"> Needs assessment, planning and budgeting Definition of requirements Choice of procedure | <ul style="list-style-type: none"> Invitation to bid Award | <ul style="list-style-type: none"> Contract management Order and payment |

Source: Authors' own compilation

One can clearly notice that all phases are vulnerable to various risks. In order to address these risks, it is important to ensure that the process is transparent (i.e. complete information provided for all involved), there is sufficient professionalism of officials (i.e. better planning and execution of the procurement activities) and that there are adequate accountability and control mechanism (better monitoring and accountability chains and institutions). A good procurement practice calls for process which promotes

³ According to the public procurement law in Kosovo, public procurement activity means any activity connected with the initiation or conduct of a procedure or other activity that leads to or is intended to lead to the award of a public contract.

⁴ Public Procurement Legislation in some countries restricts changes during the implementation phase. They must be retendered in order to ensure competitive process.

fairness, efficiency and minimization of corruption and misuse of taxpayers' money while it maximizes the economic and social gains of public procurement. Next we briefly discuss the risks faced in each phase of the procurement process:

- (i) There are great risks that the procurement process faces during the **pre-bidding phase**. The first and foremost problem is the lack of adequate needs assessment by contracting authorities. This sequentially leads to poor procurement planning and budgeting. In addressing this matter with the aim at ensuring better value for taxpayers' money, a higher degree of integration of procurement process into the overall public expenditure management process is recommended. That is to say that procurement should not be treated as purely technical process; specialist of this field should be involved in the decision making on how agencies manage their assets and spend their resources. In this direction, countries are increasingly investing in human capital to enhance the efficiency in procurement process and reduce temptation for corruption. That is done by either improving the skills of current practitioners or by attracting high-skill professional through adequate incentives.⁵ Another good practice employed in different countries is the rotation of officials involved in procurement process. This practice proved to be very useful to avoid prolonged contacts between contracting authority and economic operators. It was particularly successful in those positions which are sensitive or involve long-term relations and where the number of companies competing is limited.

Another risk in the pre-bidding phase of the process is the definition of requirements (specification and award criteria). Sometimes procurement practitioners define the specifications so that they appear to be tailored for a particular company. Moreover, the award criteria are too vague hence leaving room for misuse. The role of the overseeing institutions in these cases is very important so that genuine competition is ensured.

Even though the open procedures are predominant techniques in most of the countries, procurement laws and regulations leave room for other alternative non-competitive procedures. These procedures should be used only under exact conditions (for instance: if the product/service is of specific nature and there is genuinely no competition; the value of the contract is very low or in cases of emergencies). However, the risk of abuse of non-competitive procedures on the basis of legal exceptions still remains high. In some countries, procurement practitioners have split contracts so that they fall within the 'low value' ceiling; abuse of the specificity of the product or service; abuse of extreme cases/emergencies, among others. The definition of criteria for using these procedures should be very strictly set in primary and secondary legislation.

- (ii) During the **bidding phase**, the level of information might not be uniform across all actors. Attracting a sufficient number of bidders in public procurement through processes that are open and fair is a key concern. The information sharing should be ensured by imposing strict legal provisions that oblige contracting authorities to provide equal set of readily accessible information to all parties. This would ensure greater competition in the process. Also at this stage there is a risk of collusion among bidders leading to inadequate prices or even illegal price fixing. The latter should be closely scrutinized by the competition commission who should have credible commitment to punish any misconduct in this direction.

Another set of risk at this stage is related to awarding contract. This segment is prone to conflict of interest and corruption resulting because of financial gains (as bribe) or because of familiarity with the bidders (who might return the reward in non-financial gain).

- (iii) **The post-bidding phase** is also exposed to certain risks. There is great risk of failure to monitor performance of contractors in particular lack of supervision over the quality and timing of the process that results in: (a) substantial change in contract conditions to allow more time and higher prices for the bidder; (b) product/service substitution or sub-standard work or service not meeting contract specifications; (c) theft of new assets before delivery to end-user or before being recorded in the asset register. Also, there is a risk that sub-contractors and partners are chosen in a non-transparent way or not kept accountable, as well as false invoicing for goods and services not supplied and for interim payments in advance of entitlement.

The main determinant of an efficient procurement system is the availability of supervising mechanisms and capacity to ensure effective control. The first element in this framework is the existence of internal control mechanisms. These mechanisms act as a management instrument for improvement in the procurement system of an organization. These internal controls are used as tools in many countries to check compliance with public procurement procedures. However, these mechanisms should be amplified by external controlling/auditing mechanisms. Existence of such external controls increases the efficiency of the internal mechanisms given that it acts as an overseeing entity of the latter. What is more, in order to respond to citizens' demands for greater accountability in the management of public expenditures, some countries have also introduced direct social control mechanisms by closely involving stakeholders, not only the private sector but also end-users, civil society, the media or the public at large, in scrutinizing integrity in procurement. In several countries, it is common for the legislative branch to be involved in reviewing procurement activities, either through parliamentary committees or an ad hoc committee for investigating specific issues.

⁵ One of the incentives is the efficiency wage is discussed in more depth later in this section.

Promoting more efficient and transparent procurement processes led countries to increasingly launching e-procurement systems. Using CIPS (2011), we define e-procurement as:

"[A] use of the internet to operate the transactional aspects of requisitioning, authorizing, ordering, receipting and payment processes for the required services or products."

There is a lot of evidence to support that benefits from the use of electronic procurements outweighs set-up costs.⁶ Therefore recent years have seen a massive move towards establishing new e-procurement infrastructures. However, countries are increasingly becoming more aware that for the digital infrastructure to succeed, it should be secure and have sufficient integrity. Moreover, for establishing an effective e-procurement, it is necessary to create an enabling environment. The most important of all components of this environment includes the strong political support commitment. Without such commitment, development of e-procurement system is impossible. This should be reflected in the legal framework which will require a mandatory use of electronic procurements. Secondly, it is important that this infrastructure is implemented gradually so that it allows sufficient time for all actors to adopt; it should be designed to be unfolded as an iterative process, so that it improves by internalizing the experience gained after each step. The system should be user friendly however it should be accompanied by constant trainings for both procurement practitioners and bidders alike. Effective e-procurement systems have proved to be money savers by ensuring a quasi 'perfect competitive' market in public procurement. Some countries used these money savings to design a special incentive scheme for procurement practitioners to provide higher wages or to use them in development programs in this field.⁷

-Corruption in public procurement and ways to control it

Literature suggests that corruption is pervasive in public procurement. OECD (2007) finds that corruption in procurement is more pervasive than in utilities, taxation, judiciary and state capture. This clearly illustrates the size and scope of corruption that, inevitably, accompanies this process. As we already established, public procurement is very important driver of the economic development.

⁶ For details see: OECD (2000)

⁷ Efficiency argument is put forth in previous paragraphs.

Likewise, misuse of this process is usually responsible for many malfeasances in the economy. It leads to misallocation of resources, distorts markets, discourages investments, and distorts income distribution (Jain, 2005). It contributes in creating uncertain business environment. Today, this phenomenon occupies a high position in the research agenda of international organizations since the necessity to act towards controlling it has become essential. Misused public procurement process involves higher transaction costs due to the uncertainty and secrecy that necessarily accompany bribe payments (Shleifer and Vishny, 1993). These extra costs might distort the market and deter firms from entering the market altogether.

We start by defining three elements which are prerequisites for corruption to exist. Many authors including, Becker (1968), Klitgard (1988), Jain (2005) and others, have identified these elements:

- (i) **First**, someone must have discretionary power over allocating certain resources. Once the official has this power, he/she can easily engage in rent seeking activities. The greater the power in controlling resource allocation the greater is the incentive for engaging in corruption (Jain, 2005). Johnson et al. (1997) claim that more discretionary power for officials leads to '...a higher effective burden on business, more corruption and greater incentive to move to the unofficial economy' (p.387).⁸ It is argued that officials have more power in highly regulated economies as this represents a fertile soil for corruption. Rose-Ackerman (1978) has noted that discretionary power is associated with the level of regulation. In a free market economy the level of discretionary power is considered to be low and so is the level of corruption. Economic reform aimed at liberalization is expected to help lowering the level of corruption however the involvement of government in this process on the other side, increases opportunities for corruption (Weyland 1998, p.111).
- (ii) **Secondly**, there must be an economic rent associated with this power. The higher the rent, the higher is the incentive for engaging in corruption. This condition together with the first one is mutually inclusive since they cannot lead to corruption separately. In other words, if the official has discretionary power which is not accompanied with an economic rent, he/she does not have an incentive to engage in corruption. Similarly, the existence of an economic rent cannot lead to corruption if someone does not have control over the allocation of that particular good or service.
- (iii) Finally the probability of being detected or caught should be low. If this probability is high, then the incentive for engaging in corruption is weaker and vice-versa.

⁸ The problem of informal economy will be addressed later in the chapter.

Becker (1968) described the first two conditions as incentives for engaging in corrupt activities while the third one as a restraint. These elements were summarized by Klitgaard (1988) as follows:

$$\mathbf{C} \text{ (corruption)} = \mathbf{M} \text{ (monopoly)} + \mathbf{D} \text{ (discretion)} - \mathbf{A} \text{ (accountability)}$$

The opportunity for corruption is a function of the size of the rent under a public official's control (M), the discretion that official has in allocating that rent (D) and the accountability that official faces for his or her decision (A), (Klitgaard, 1988). So in order to minimize the likelihood of corruption in procurement process, the government officials should retain minimal discretion while the level of punishment if caught should be increased. The latter should be coupled with a credible commitment from the law enforcing agencies.

In order to have a clearer picture of corruption in public procurement, we start by analyzing it following two different strands of literature. The first strand of the literature considers misuse of public money as a "Principal-Agent" problem. The principal agent theory suggests that misuse occurs as a consequence of information asymmetry and it is costly for the Principal (government in this case) to overcome this asymmetry. The government is considered to have innocent motive, and that it is only the procurement officer (the agent) who misuses the power. This model treats a corrupt official as an agent, who balances the potential benefit of engaging in corrupt activities against the potential cost or consequence. Therefore an agent would chose to be involved in misuse of public money if the perceived benefit outweighs the potential consequences.

The level of bribe is of great importance in inducing the agent to decide to engage in corruption. Governmental officials might find the increased income from corruption irresistible (Jain, 2005). However if the probability of being caught is high, then the overall expected utility of corruption is reduced.

If the wage of the agent is increased, the utility of the agent to involve in corruption is also reduced. Many authors (e.g. Becker and Stigler, 1974) employ the concept of efficiency wages, which is the wage that is higher than market clearing one, to combat corruption as Principal-Agent problem. Efficiency wage acts as a barrier to corruption since it increases the opportunity cost of being caught. It is a mark-up on the market wage equal to the temptation of malfeasance (Aidt, 2003).

There is a general agreement that efficiency wage lowers the number of corruption indices. However those who still choose to engage in corrupt activities will charge a higher price to offset the risk of getting caught.

This therefore, might lead to a higher net level of corruption (Mookherjee and Png, 1995). Generally the hypothesis that high wages are associated with low corruption levels has so far largely

failed to find empirical support in studies that use data across countries (Di Tella and Schargrodsky, 2003)⁹. An increase in the size of penalty, if caught, would lead to a decrease in the expected utility to engage in corruption. An increase in the level of punishment represents another effective way to control corruption. However, designing a precise scheme of punishment is complicated process, and as Rose Ackerman (1975) suggests, if the punishments are ill-designed, this would encourage rather than discourage corruption. Conclusively, the Principal-Agent model of corruption does not go far beyond the usual parameters of the Principal-Agent model, which include setting a payment and penalties and gathering information (Klitgaard, 1988).

Up until now the Principal (government) was assumed to have innocent motives. Another line of thought questions this assumption and considers that all parties (government and its officials) can be corrupt. This view dates back to Buchanan and Tullock (1962); Olson (1965); and Becker (1983) and advanced later by Shleifer and Vishny (1993 and 1998, chapter 1). They adopted the term 'grabbing hand', maintaining that government introduces regulations in order to empower and enrich the politicians (Shleifer and Vishny 1998). This model seems to suggest that large firms or lobbying groups can 'capture' the government through financing their campaigns among others, with politicians in turn acting on their behalf by approving legislation which are in favour of those companies/parties. The interest-group theory suggests that these groups can capture regulatory bodies which are supposed to regulate the system (Stigler 1971; Posner 1974; Peltzman 1976; Becker 1983). Corruption at governmental level is often responsible for creating non-competitive market situations. As a consequence of corruption at governmental level, key state institutions are captured by firms to skew the process of policy-making in the interest of particular groups, contributing further to creating a more non-transparent government and unfair competition. In case a corruption as a principal-agent problem (in which the government is not involved in corruption), imposing transparent regulation in key administration positions, where the interaction with business community is high, is considered to contribute in lowering corruption. In particular, protecting whistleblowers and having credible punishment stance results in eliminating a significant proportion of corrupt activities. On the other hand, tackling the supply side of corruption,¹⁰ we can say that business community should get aware that even though corruption might have facilitating role in their daily operation in the market, it is at the cost of another firm and this in turn contributes in dete-

9 See, for example, J. Rauch and P. Evans, 'Bureaucratic Structure and Bureaucratic Performance in Less Developed Countries', *Journal of Public Economics*, no. 75/1 (2000); and D. Treisman, 'The Causes of Corruption: a Cross-national Study', *Journal of Public Economics*, no. 76/3 (2000). See also, however, C. Van Rijckeghem and B. Weder, 'Bureaucratic Corruption and the Rate of Temptation: Do Wages in the Civil Service Affect Corruption, and by How Much?', *Journal of Development Economics*, no. 65/2 (2001), in which there is a smaller sample of countries.

10 By supply side of corruption we do not imply that firms willingly offer bribes, they rather see corruption as the price they have to pay for being awarded a contract.

riorating the market altogether. This would consequently lead to lower profit due to continuously raised level of corruption. In cases where corruption is manifested as a 'grabbing hand', the problem seems to be of greater magnitude. In that situation, apart from what is proposed in previous paragraph, there should be a mounting pressure from all stakeholders (primarily the parliament, business community, political parties, civil society and media) towards the government in requiring higher level of accountability. Literature suggests that all stakeholders should act as important actors in controlling and combating corruption in public procurement process.

SECTION 2

Public Procurement in Kosovo

-Background and the institutional setting

As a transition country, Kosovo started building its new institutions that will facilitate a market-led economy only in 1999. However, this process started later than elsewhere in Eastern Europe following a decade of emergency ruling and a devastating war. Part of the transition course was the process of introducing public procurement process and practices. So, the public procurement system in Kosovo is very recent. The International Community made their first attempt at introducing public procurement as early as 1999¹¹, but the first Public Procurement Law (PPL) with the involvement of the Provisional Self Governing Institutions was only brought up in 2004 (Duli, 2008).

The new legal framework marked several advancements in public procurement process while aiming an alignment with EU directives. However, practical implementation was facing major difficulties. It was followed by delays in establishing central procurement institutions which in turn postponed the process of preparing secondary legislation which further perplexed putting it into practice. According to the EC (2005), the then enacted PPL proved to be very complicated to apply and incurred higher costs for the Kosovo Consolidated Budget. Also, EC (2005) finds that this law created conflicts of interest between the regulatory and judicial review functions of the PPRC. As such, law has been subject to great revisions and improvements. The new draft law was then presented to the Assembly in 2006 which intended to further align with EU acquis in this field; however, the alignment process was considered to be lagging behind (EC, 2006; p. 27). The new version of the law, amending the 2004 PPL was promulgated in June 2007. The aim was to make it more practical which increasing conformity with EU acquis and best international standards and practices of public procurement.¹² The new law changed, inter alia, the institutional structures for public procurement requirements, amending rules for appointing procurement officers (including their training), and framework agreements, as well as providing for new rules on the three

central procurement institutions in Kosovo: Public Procurement Regulatory Commission (PPRC), the Procurement Review Body (PRB), and the Public Procurement Agency (PPA) (EC, 2007; p.32). Box 1 presents the structure of the public procurement institutions in Kosovo.

Aiming at further improving the public procurement process, in 2010 the new law was presented by the government to the assembly. Even though that the process of drafting new legislation was highly supported by EU technical assistance, the input from this expertise was not reflected in the presented law. Accordingly the findings of the EC were that the new law, which entered into force on 1st of December 2010, diverged significantly from the acquis. This law has been consequently criticized heavily by the EU commission and other independent observers arising doubts about the motives of the government who did not internalize the proposals of technical working groups in the legislation. This law contained a number of provisions that exposed procurement officers to political interference and pressure, and thus undermining the transparency and accountability of the overall process and opening up opportunities for corruption (EC, 2011).

Since the law was considered to be in conflict with some of the EC Procurement Directives there was a mounting pressure from the former towards the government. This raised the need for legislation changes which were authorized in 2011. So, the law remained in force for only 10 months until it was changed during 2011.¹³ The new Law on Public Procurement No. 04/L-042, was approved by the Assembly of Kosovo on August 29, 2011, was published in the Official Gazette of Kosovo, No. 18 on September 19, 2011, and entered into force on October 05, 2011. Under this law in Kosovo remain two central procurement bodies: Public Procurement Regulatory Commission and Procurement Review Body, and whereas the Central Procurement Agency passes under the Ministry of Finance. The training of public procurement practitioners is conducted by Kosovo Institute of Public Administration with the support of PPRC. PPRC has prepared around 90 percent of secondary legislation for the current law which were enacted in the beginning of 2012 (PPRC, 2012).¹⁴ Recently they have also developed a procure-

11 These procurement procedures were similar to the procurement rules of the World Bank and UNCITRAL.

12 It has incorporated most of the provisions of two procurement directives of the European Commission, No. 17/2004 and 18/2004.

13 PPRC has not prepared at all secondary legislation to implement this law, but has instructed the contracting authorities that they can use secondary legislation according to the previous law on procurement

14 The secondary legislation includes among others: the tender dossier frameworks for all procurement procedures, contract notice and contract awarding notice, procurement ethical

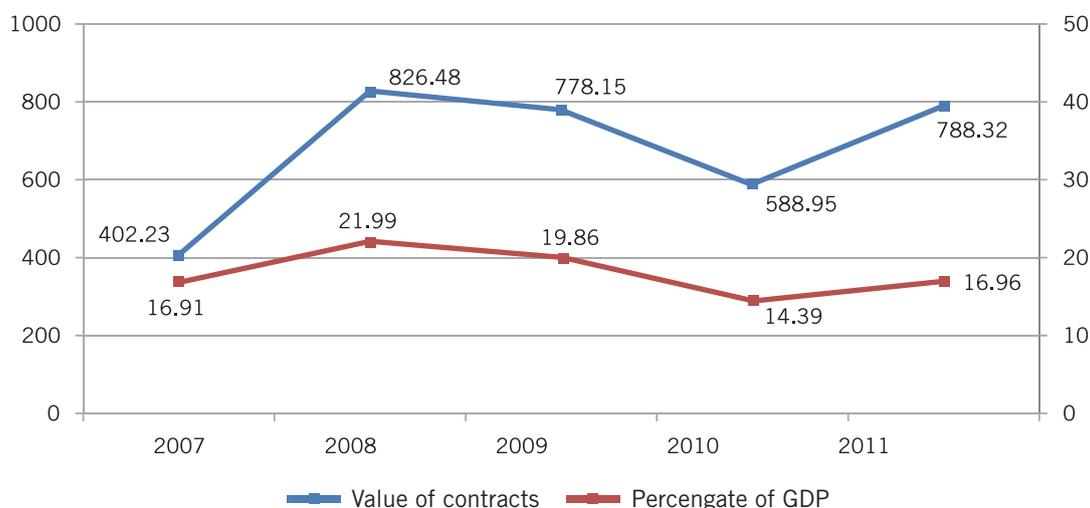


FIGURE 1. Value of signed contracts and their extent as proportion of GDP (value in million Euros; proportion in percentage)

SOURCE: Authors' compilation based on PPRC annual report (various years)

NOTE: Values of contracts should be looked in the left vertical axis whereas the percentage of GDP in right vertical axis.

ment procedures process flow chart which helps the practitioners not to miss out a step during the process.¹⁵ The new legislation has broadened the accountability for procurement processes to include not only procurement officers, but also their superiors, both at administrative and at political levels. While the independence of procurement officers was reinforced in the new version of the law (also by transferring more competences which aim at reducing bureaucracy and giving some degree of autonomy), still they remain in a weak position and subject to intimidation. What is more, the increased competences of public procurement officials are expected to increase their exposure to greater pressure from their superiors.¹⁶

Overall, the procurement legislation is largely in line with European standards however the compatibility has significantly increased only in the last version of the law. Kosovo still needs to improve the legal framework in the public procurement area and the amending process should be more comprehensive internalizing the input from other relevant stakeholders. The coordination mechanisms of the main stakeholders in the public procurement system need to be further strengthened, in particular to reduce the scope for corruption. Awareness of public procurement procedures by contracting authorities and economic operators needs to be raised and independence as well as the professionalism of the public procurement officers needs to be further enhanced. Moreover, the monitoring and follow-up of procurement activities

needs to be improved, including actions aimed at helping to ensure that oversight agencies' recommendations are implemented and that officials are held accountable for their actions.

-Procurement activities in Kosovo

Public procurement makes up close to one fifth of Kosovo's economy. Therefore, it is very important to create a system that allows this process to be conducted efficiently and transparently in order to provide a level playing field for the companies participating in the process, while ensuring better value for taxpayers' money. Public procurement activities in Kosovo are monitored by the Public Procurement Review Commission. Contracting authorities¹⁷ are legally obliged to report all their contracts.¹⁸ The following subsection reviews the procurement activities in Kosovo in the last few years including the appeals of parties involved in the process which are submitted to Procurement Review Body.

-Public procurement as share of the economy

As already established, public procurement is an important component of countries' GDP. Countries that managed to establish and maintain an efficient public procurement process have been

code, documents about the diplomatic missions as well as other templates used daily by procurement practitioners.

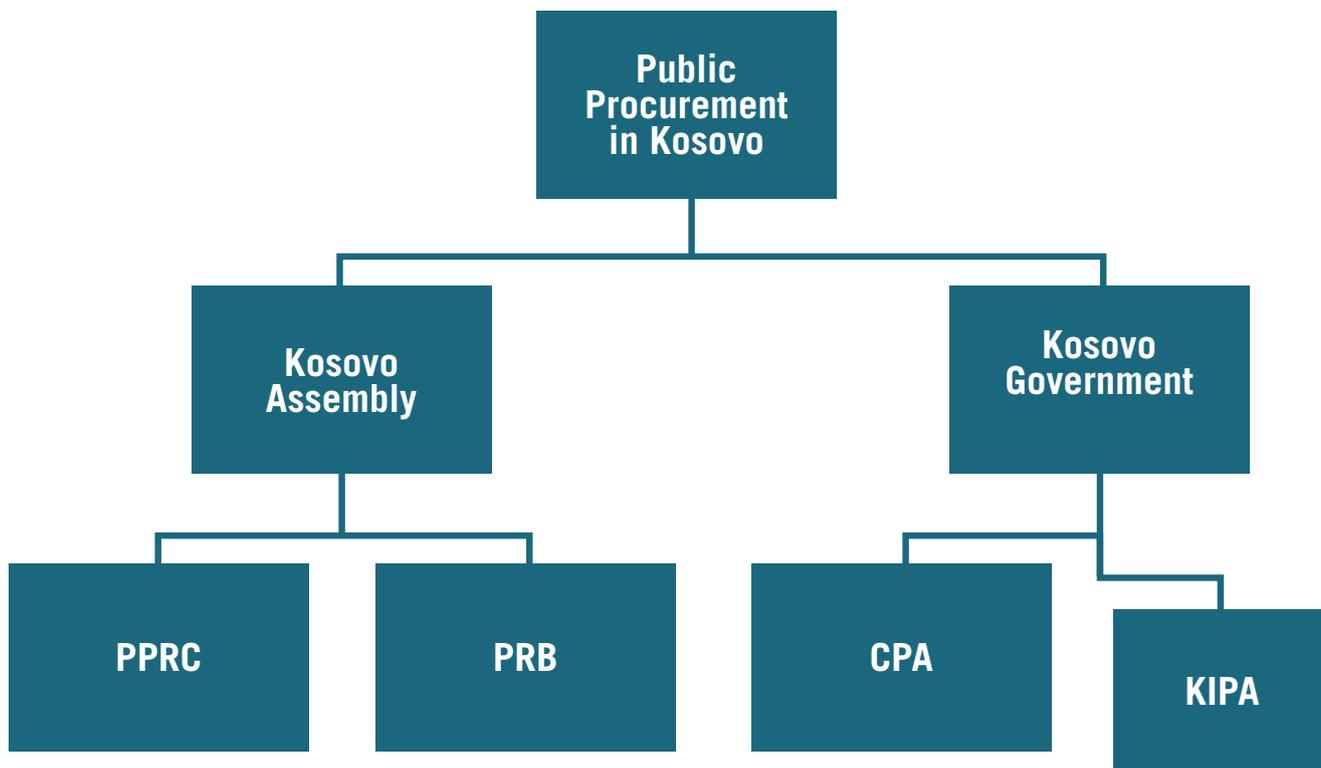
15 The process flow chart was welcomed by public procurement officials (Riinvest interviews, 2012).

16 This was also suggested in interviews with public procurement officials (Riinvest interviews, 2011)

17 There are 161 contracting authorities in Kosovo as of 2011. The number has been on an increase due to establishment on new governmental organization.

18 Sigma (2011d) finds that the reporting and statistical system of PPRC is satisfactory.

Box 1. The structure of public procurement institutions in Kosovo.



- 1.** The Public Procurement Regulatory Commission (PPRC) is an independent regulatory agency. It is in charge of establishing the detailed implementing rules of the PPL and is responsible for the overall development, operation and supervision of Kosovo's public procurement system. It consists of five members nominated by the government and appointed by parliament for five years.
- 2.** The Procurement Review Body (PRB) is an independent body responsible for implementing review procedures. It is a quasi-judicial body competent to review administrative decisions issued by central procurement institutions (PPA and PPRC) with regard to the conduct of procurement procedures, and to review appeals from tenderers under the review procedure.
- 3.** The Central Procurement Agency (CPA) is established within the Ministry of Finance and is in charge of central and coordinated purchasing but also supporting contracting authorities with professional expertise.
- 4.** The Kosovo Institute of Public Administration (KIPA) is a government institution in charge of training and licensing the public procurement officers.

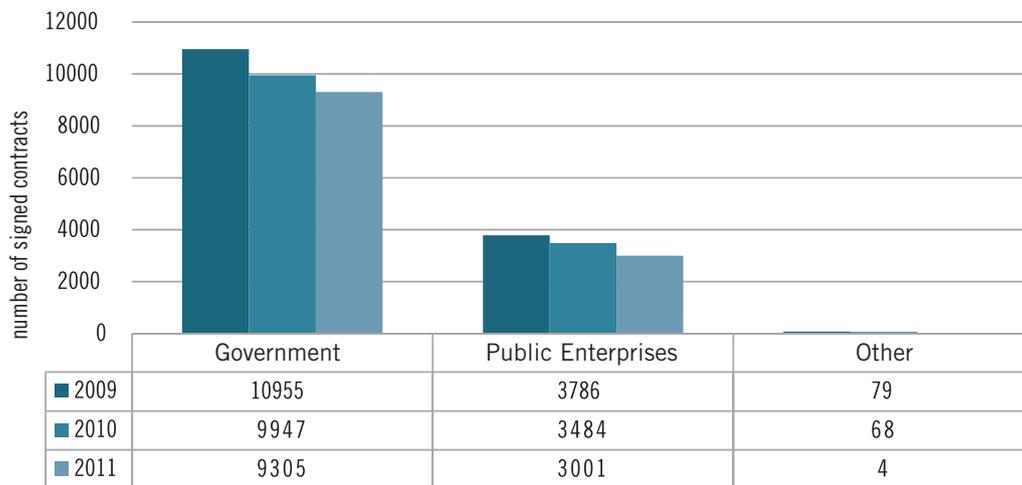


FIGURE 2. Number of signed contracts

SOURCE: Authors' compilation based on PPRC annual report (various years)

able to use it as a tool to boost the economy while promoting competition and efficiency. Failing to do so, distorts the market and creates a state-sponsored non-competitive environment which impedes businesses to grow while diminishes incentives for entrepreneurial activities. Public procurement activities in Kosovo have great impact on the economic development of the country given their proportional weight in the national economy. The value of procurement activities in the last five years averages at 18 percent of GDP. While it peaked at around 22 percent in 2008 it was followed by a steady decline in the next two years before beginning to catch up again in 2011. Similar pattern was observed in terms of the monetary values of the contracts. After having a relatively loose fiscal policy during 2008 and 2009, the trend has gradually started to change its course in 2010 and 2011. A more restrictive spending pattern emerged mainly due to increased risks of potential budget deficits (Riinvest, 2011). Figure 1 depicts the value of signed contract and their extent as proportion of GDP.

-Number of contracts signed, value and type of contracting authorities

The number of contracts signed by contracting authorities using PPL has decreased in 2011, however in value terms (as seen at the beginning of this section), it has increased. Figure 2 presents the number of signed contracts in the last three years according to the type of contracting authorities (government institutions, public enterprises and other entities). In general during 2011, the number of signed contracts was 12310 which is about 10 percent lower than previous year (similar drop was noticed in 2010 compared to 2009). This pattern is the same in all three groups of contracting authorities. As for the government institu-

tions, this is partly explained by the increasing use of framework contracts and centralized procurements by contracting authorities.¹⁹ Further increase of the latter is recommended given that buying in bulk increases the value for money by improving price conditions. Also the public enterprises reported to use centralized procurements for all departments and subsidiaries.

Data show that over 75 percent of signed contracts are governmental contracts, i.e. contracting authorities using taxpayers' money. Around 25 percent of signed contracts are of public enterprises and a negligible number of contracts (under 1 percent) are contracts signed by other organization that use public procurement law as a governing framework of their procurement activities (that includes institutions which are not obliged to use PPL but still chose to do so; for instance some NGOs). The use of PPL by public enterprises is reported to have created some practical problems. Since some legal provisions are very rigid and involve a lot of bureaucracy, the implementation proved difficult in competitive environment. Investments decisions of public enterprises (especially in Telecom industry) seem to be obstructed by the inflexibility of the public procurement law. This in turn lowers their competitiveness, making it more difficult for them to increase or even maintain their market share.

As for the sources of finance, majority of money came from Kosovo Consolidated Budget (around 60 percent in 2011; 9 percentage points lower than 2010 and around 17 percentage points lower than 2009). Of the remaining money, majority were POEs own funds and the negligible share were money of other

¹⁹ In 2011 there were 211 framework agreements. We cannot give a comparison with previous years as the number of framework agreements was not reported before 2011.

Table 2. Sources of finance according to contract values

| Sources of Finance | Value of contracts 2009 | Value of contracts 2010 | Value of contracts 2011 |
|----------------------------|----------------------------|----------------------------|----------------------------|
| POEs' own funds | 23.00% | 31.02% | 40.25% |
| Kosovo Consolidated Budget | 75.38% | 67.68% | 58.65% |
| Donations | 1.63% | 1.30% | 1.10% |
| Total | 100.00% | 100.00% | 100.00% |

Source: Authors' compilation based on PPRC annual report (various years)

contracting authorities (Table 2). It should be mentioned that a fraction of the money spent by public enterprises also include taxpayers' money; accounting for the level of subsidies that they receive from the government. The subsidies were significantly reduced during the last year however they still account for a significant proportion of companies' money (especially in the energy sector; KEK and Termokos being the most representative examples).

-Types of public procurements

In terms of procurement types, most of the procurement activities (over 50 percent) are works contracted by the government.²⁰ Other procurement types contracted by the government include supplies (around 40 percent), services (around 8 percent) and design contests (around 0.5%). While the types of procurements are set at political level, it is important to view them in conjunction with type of procedures used at the implementing level.

Type of procedures used by contracting authorities is another aspect of public procurement process which was scrutinized by interested observers (EU commission among them). Figure 3 shows the proportion of contracts according to different procurement types in Kosovo in the last four years. As one can note, open procedures account for over 80 percent of total value of signed contracts. However reader should note that the graph in the last 2 years does not include the contract of for construction of Morine-Merdare Highway. The latter alone accounts for around 18 percent of total value of signed contracts while in 2011 it accounts for around 30 percent. The other methods are very marginally used. The increased usage of open procedure signals improvement in public procurement process given that this method is less prone to corruption while it encourages competition. However one might see that the negotiated procedures without publication of the contract notice (widely referred to as single source tendering) still remain high (at 6.1 percent in 2011). It has decreased from peaking level in

2008 when it reached 19 percent of total value of signed contracts. At that time, this raised great worries for the all observers of the process including, the European Commission (EC, 2008), General Auditor and civil society organizations²¹. The level of single source tendering has fallen subsequently in 2009 (at 11 percent) and in 2010 (at 7 percent) however it is still considered as high and its application should be restricted to cases when there is no other alternative. The latter should be more closely monitored by the overseeing institutions and more credible actions should be taken accordingly.

-The evaluation criteria of the public procurements

The evaluation criteria must treat all bidders in an equal manner. They must seek to foster transparency and efficiency. In various cases, EC raised worries about the objectivity of evaluation criteria used in procurement process in Kosovo. According to the contract award criteria, lowest price criterion continues to dominate the overall value of total number of contracts (Figure 4). Lowest price accounts for almost 85 percent of the value of total contracts. It exhibited a slight increase from the previous year with over one percentage points. However it is substantially higher compared to 2009 when it accounted for just over 54 percent of the value of total contracts. Using lowest price simplifies the procurement process and it is theoretically expected to increase the objectivity in selection; however there are some drawbacks that this method suffers from. Initially, there are some types of procurements (especially services) in which it is very hard to make objective comparisons based only on price. Also, firms after being awarded with the contract, can compromise the quality of the service or good supplied and therefore are able to afford bidding with lower prices. Moreover the official who has discretion over awarding the contract (or controlling the quality of service or good supplied afterwards) might be driven by corruption (as purely financial gain)

²⁰ A work means the outcome of construction or civil engineering works or activities that, taken as a whole, is sufficient to fulfill an economic or technical function.

²¹ For an extensive review of research by the Civil Society Organizations, the reader is referred to publications by different Civil Society Organization including Riinvest, GAP, INPO, IPOL, and FOL among others.

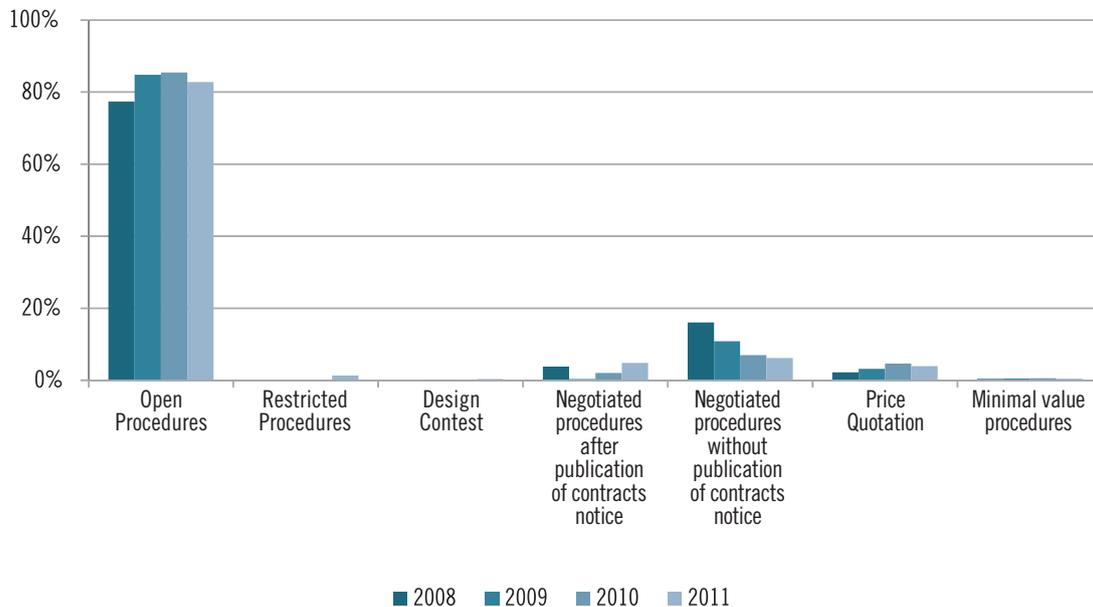


FIGURE 3. The proportion of contracts according to different procurement types
SOURCE: Authors' compilation based on PPRC annual report (various years)

or by other corrupt practices (such as nepotism or favoritism) and therefore selects/accepts the provision of lower quality product of service. This is not to say that we should not use 'lowest price wins' method; we are merely implying that we cannot rely heavily on this method especially in awarding service contracts. Moreover, even though one would expect that this method gives less discretion to the government official, still it is not a misuse proof method given the potential of ex-post malfeasances. Another aspect that needs to be closely looked at is the issue of abnormally low tenders. While the PPL stipulates that if the tender appears to be abnormally low in relation to the object of any procurement procedure tender may be rejected but only after the tenderer has had an opportunity to explain the offer submitted. If the offer is justified then the he contracting authority shall treat such tender in the same manner as any other tender. Otherwise it is rejected and PPRC is informed accordingly. It is important to have very objective measures of what constitutes abnormally low price so that the public procurement officer can tell when it is reasonable to believe that the economic operator has submitted an un-performable tender.

The remaining contracts are awarded based on most economical-ly advantageous tender (MEAT) criterion. Similarly MEAT has its advantages primarily in weighting the quality elements. However, similarly MEAT has its drawbacks as imposing more criteria gives greater discretion to the procurement officers who in turn might misuse it. It is very important to set criteria so that they are proportionate with the size and scope of the contract. For a small contract,

it would be inappropriate to require very ambitious requirements²². What is more, additional criteria might impose unfair competitive grounds for companies. For instance, using experience as criteria at the awarding process may preserve the advantage of the incumbent supplier. Besides, procurement officers can set specific criteria that suit the specificity of a particular company, hence increasing the chances to be awarded a contract.

Conclusively, in cases of assessing a complicated contract over a whole set of criteria, as opposed to solely the lowest price, is expected to foster achieving higher value for the money. However, when purchasing simple commodities, the lowest price criteria may be appropriate. Evaluation on the basis of price alone may also be appropriate in the procurement of specific works contracts where the bill of quantities or schedule of rates is so prescriptive and detailed as to the quality standard that lowest price can be applied. In any case, it is important that contracting authorities publish their evaluation criteria and scoring methodology so that it is transparent promoting equal opportunities and equal treatment of all current and potential suppliers.

²² Our survey results reveal that companies in many occasions have the impression that the criteria are not proportionate with the scope of the contract. In turn this creates an uneven competing position for companies discriminating against smaller firms.

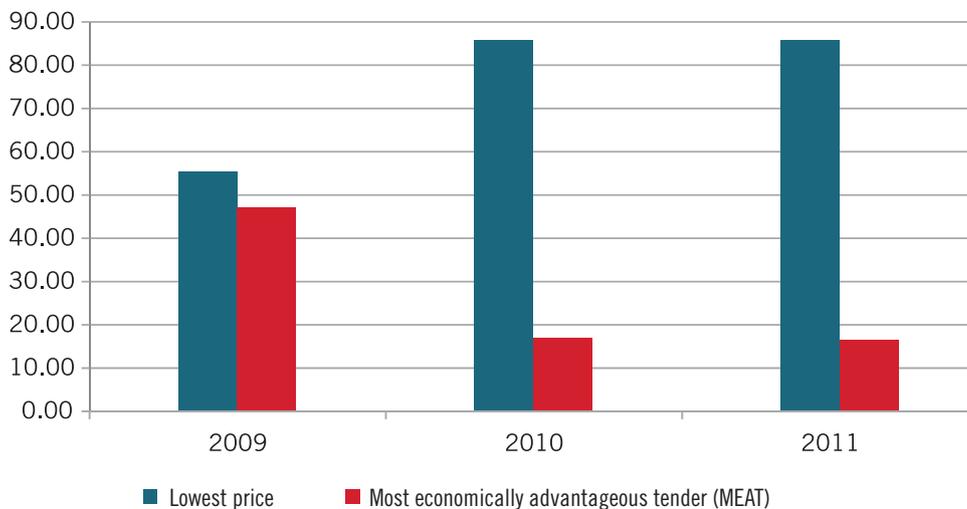


FIGURE 4. Proportion of signed contracts according to the contract award criteria
 Source: Authors' compilation based on PPRC annual report (various years)



FIGURE 5. Proportion of foreign and domestic firms in public procurement process in Kosovo
 SOURCE: Authors' compilation based on PPRC annual report (various years)

-Level of competition in public procurement and proportion of cancelled contracts

Level of competition in the procurement process has exhibited a slight decrease during the last year. The average number of companies bidding for a tender stood at 5.1 compared to average 5.9 in previous years²³. Another important element which shows some good advance-

ment in recent years is foreign competition in public procurement process. The proportion of foreign economic operators winning public contracts has increased in recent years²⁴. The presence of foreign EO increases competition and hence the potential for increased value for money from procured goods and services. However, the foreign companies still lack information about the contract opportunities in Kosovo. Also, EC (2008) finds that some parts of the legislation (primary and secondary) still have

²³ Our survey findings suggest that companies have started to lose trust in the process hence they are self-selective in bidding. They maintain that in a lot of cases the winner is known once the invitation for bid is published (Rinvest, survey 2011).

²⁴ Public Procurement Law does not discriminate between local and foreign EO. It specifically requires equal treatment between EO.

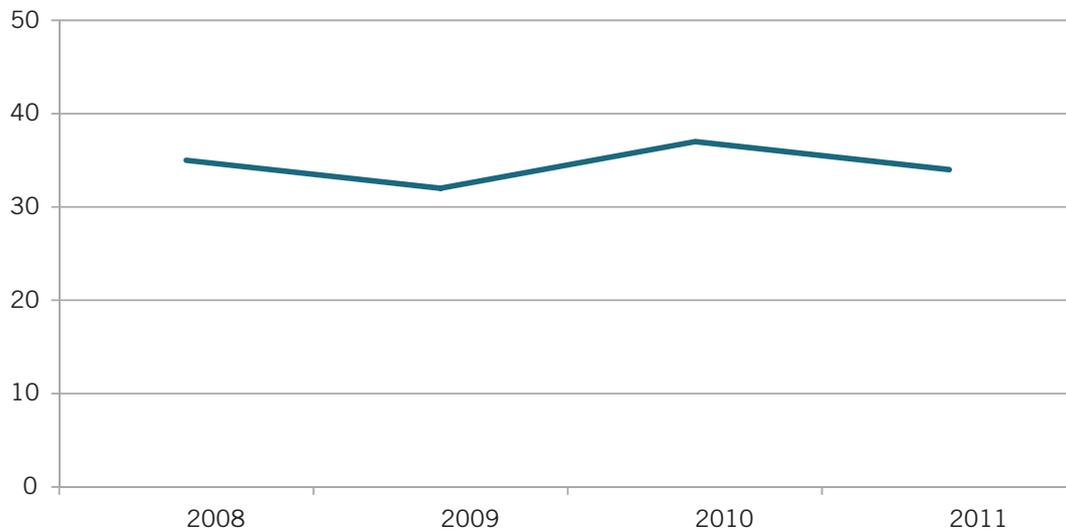


TABLE 6. The proportion of cancelled contracts (in percentage)
SOURCE: Authors' compilation based on PPRC annual report (various years)

some discrepancies between different language versions might act as a deterrence for involvement of the foreign companies. Figure 5 depicts the proportion of foreign and domestic firms in public procurement process in Kosovo in the last three years.

As discussed, the value of contracts awarded through public procurement has increased; however the high proportion of tenders cancelled give rise to concerns. Figure 6 depicts the proportion of cancelled contracts. On average around 35 percent of contract notices are cancelled on different grounds. The main motive for cancelling a contract is the reason that contracting authorities have received less than two responsive tenders or requests to participate (exceeding 80 percent of cases). Low number of responsive tenders was the main reason of cancelation also in previous years (note that before December 2010, the number of required responsive tenders was three). It was believed that lowering the number of required responsive tenders will remedy the problem; however it was proved not to be the case given that there was only deterioration after lowering the number of required responsive tenders after law amendments were enacted in December 2010. This might signal that because companies lack sufficient trust in the process they are reluctant to take part in it. This assumption was backed by findings of our research with the private sector (see Section 3 for further discussion)²⁵.

The other reasons for cancelling a contract notices include requests for cancellation by authorized authorities, price of bids and other circumstantial reasons.

-Training and licensing of public procurement officers

The training and licensing of procurement officers is a legal requirement. Every procurement officer has to undergo at least 15 days of mandatory training every year²⁶. Training is provided by the Kosovo Institute of Public Administration and in cooperation with the Public Procurement Regulatory Commission. The training is organized in two placements: advanced and elementary. Trainings are considered to be very theoretical with no practical (case-study) approach. Trainings are also attended by some NGOs and other institutions that use public procurement procedures as the framework for governing their procurement activities.²⁷ The number of certified public procurement officials has continuously increased and currently there are round 500 licensed procurement officers. They are licensed for a three year period compared to a one year period in previous legislation. This number of licensed procurement officers is considered to be small compared with the overall budget spent on procurement. EC (2009) suggests that training and licensing of persons active in the field of procurement need to be improved in order to have independent procurement experts in key positions.

Apart from trainings offered to the public procurement practitioners, it is very important to have trainings for economic operators as well. Companies complain that tendering procedures and paperwork is very complicated and sometimes they get dis-

²⁵ The average number of companies bidding for a contract has exhibited a decline of 13 percent in 2011 compared to 2010.

²⁶ Previous legislation required that public officers attend a 10 days training which was extended by the PPL enacted in 2010 (and remained the same in the new law enacted in 2011).

²⁷ Legally, everyone is allowed to attend the trainings providing that there is sufficient space. KIPA might set a reasonable fee for participants who do not work for public institutions.

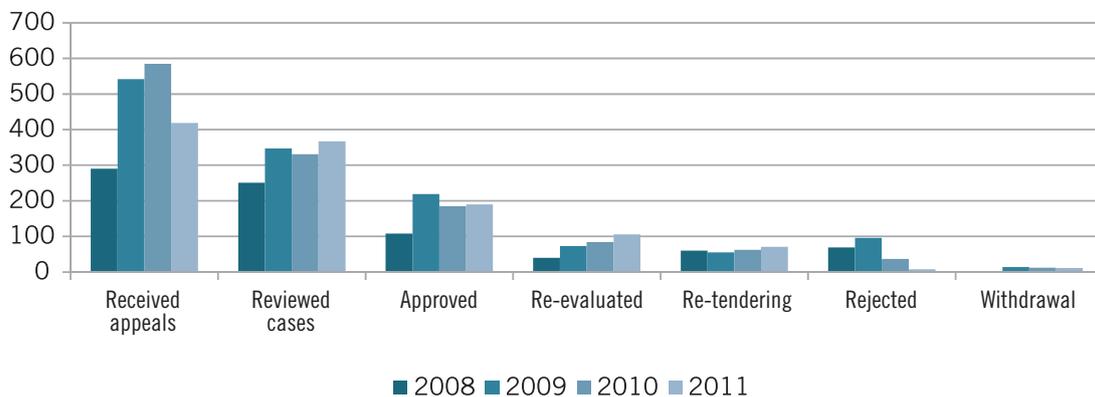


FIGURE 7. The number of appeals received and the result of the reviewing process
SOURCE: Authors' compilation based on PRB annual report (various years)

qualified due to non-technical compliance with the requirements. PPRC in cooperation with the KIPA and business associations should prepare training sessions which will be designed specifically for the economic operators.

-Appealing procedures and reviewing process

Review of appeals of interested parties (economic operators and contracting authorities), which are submitted to Procurement Review Body is done by the Review Panels composed of one member or three members of Procurement Review Body. Whereas in cases when the matter that is under review is of particular interest or particular importance; the review panel is composed of five PRB members. Procurement Review Body during the last year has received in total 419 appeals from economic operators and Contracting Authorities, who have opposed: (i) decisions made by Contracting Authorities for awarding contracts, (ii) reviews from Public Procurement Agency, (iii) interpretations made by the PPRC (Annual report, 2011). Allegations made by the appealing parties are mainly oriented to violation of legislation in force regarding Public Procurement, to decisions of Contracting Authorities during the evaluation process of the procurement activities and to award of contracts.

Figure 7 depicts the number of appeals received and the result of the reviewing process. The number of received appeals has increased from 2008 to 2010 while it has dropped significantly in 2011. Of the total number of reviewed cases, majority of them were approved (52 percent) or asked for re-valuation (29 percent). The remaining cases were re-tendered (19 percent). The Procurement Review Board issue fines to a contracting authority who do not comply with the directive. Until now only a small number of fines were issued. The capacities of the PRB need further improvements. EC (2009) reports that there is no systematic publication of PRB's decisions and these often lack

legal arguments; some advancements were recorded in subsequent years however further improvement are necessary. The credibility of this institution rests on it building an authoritative track record of review decisions as well as of avoiding conflicts of interest resulting from interaction with policy-makers.

e-procurement

As previously discussed, the use of e-procurement is driven by well-documented potential benefits of this method. The use of electronic means is increasingly encouraged in many parts of the world as a tool to promote greater transparency which results in better value for taxpayers' money. Therefore reforms that aim at the development of this infrastructure should be high up in the priority list of governments. The implementation of public e-procurement fosters simplification and transparency of procedures, increasing efficiency of budget execution, saving time and reducing costs. It also improves the consolidation of common purchases towards a centralized frame contracting approach. This in turn yields benefits of scale due to consolidated purchasing. Greater centralized procurements also strengthen the bargaining power of the procuring entities. It also promotes easier compliance of the economic operators and makes information flow easily and accessible for all. However, it also faces challenges which, if not dealt with properly, might jeopardize the whole system. First and foremost the possibility of manipulations should be ruled out. The success of the whole e-procurement system relies on the credibility of implementers' commitment to prevent manipulations in the system. If the proper level of credible commitment is there, then actors will easily adopt with the new purchasing methods.

But, needless to say the kick off in this process is the legal framework. While the previous legal setting in Kosovo did not offer room for e-procurement, the current legal framework al-

laws taking e-procurement into effect. However the details and specifics should be reflected in by-laws and decrees, hence an updating process in this regards should be considered. Currently the process of the e-procurement infrastructure is at its inception phase with the support of international donors (including World Bank and USAID) under the auspices of central procurement institutions, most notably the PPRC. It is expected that 2013 will mark the real testing phase per e-procurement.

The implementation of an e-procurement program also requires a capacity building program to go with it, so as to address the organizational challenge it faces. PPRC should provide support programs through collaborative work with KIPA and universities aiming at improving the internal capacities of the contracting authorities. Also, trainings should be provided to EO in cooperation with the business associations and training institutions.

Also in other Western Balkan countries electronic procurement is at its infancy. While Albania and Macedonia are clearly ahead in setting up e-procurement infrastructure, other countries are lagging significantly behind. In Albania, significant efficiency improvements were reported with the development of the electronic procurement system, which is now mandatory and used throughout the country (Sigma, 2011a). In Macedonia, the e-auctions system is well-established however its further enhancement and stabilization is needed. According to Sigma Country Assessment (2011b), Macedonian institutions should focus in refining the existing system instead of focusing on bringing in new electronic tools or procedural solutions in the e-procurement infrastructure. In Bosnia, the implementation of e-procurement has not yet started, although the basic steps have been taken (preparation of a basis for elaborating an Action Plan on electronic procurement), (Sigma, 2011c). In Montenegro, some e-procurement tools have been introduced or are being developed however a comprehensive e-procurement infrastructure is yet to be established (Sigma, 2011d). In Serbia, the legal framework which will facilitate the use of e-procurement is adopted; however until now, e-procurement does not play a role in practice (Sigma, 2011e). While Croatia's public procurement system has reached a high level of functionality and compatibility with the procurement systems of EU countries, it still needs to advance towards operationalization of e-procurement infrastructure. It is recommended that Croatia undertakes a feasibility study for the development of the IT infrastructure for e-procurement and, in particular, e-auction (Sigma, 2011f).

SECTION 3

Views of the business private sector

-Main findings of the research

This section analyses the main findings of surveys conducted by Riinvest on the perception of businesses related to public procurement system in Kosovo. We start by providing the profile of surveyed enterprises. This is depicted in Figure 8. We can see that the vast majority of firms subject to our survey were micro enterprises in the range of 2-10 workers. All firms with 1 employee were excluded from the survey. Around 8 percent of surveyed enterprises were small firms, while only 1.4 percent were medium sized firms. These figures are in accordance with general structure of registered firms in Ministry of Trade and Industry; ensuring thus proper implementation of sampling of this survey. In addition to the above indicators, 95.6 percent of surveyed firms de novo private firms (i.e. were private since the establishment), 3.5 percent were privatized companies (former socially owned enterprises) and 0.8 percent had other ownership structure. Last, around 92 percent of firms are domestic, with remaining 8 percent having foreign ownership.

-Impediments to doing business

With the aim of soliciting the main obstacles that companies face, the respondents were asked to express their opinion about 22 impediments by ranking their response on a Likert scale ranging from 1 to 5. Therefore, in order to be able to compare the severity of different obstacles faced by businesses in different sectors, we have calculated the weighted average of the ranking of the severity of each obstacle, using higher weighting for more difficult obstacle. We then normalized these averages to develop a score ranging from 20 to 100 (with 100 showing the most severe obstacle)²⁸. Figure 9 presents the top five obstacles faced by companies in Kosovo. Results suggest that companies suffer the most from unfair competition which (brought about by evasion and informality) with a score of over 76. The second biggest obstacle as reported by surveyed companies is the anti-com-

²⁸ For each obstacle, the rank given by each enterprise (from 1-5) is multiplied by a weight equal to the rank (also 1 to 5), i.e., the more serious obstacles get a higher weighting). The weighted average is then divided by 5 (the maximum rank) and multiplied by 100 in order to convert the score into a percentage showing how close to the maximum ranking the average rank is. In other words, the score s was calculated as: $s = (\sum w_i x_i / n) * 100 / 5$, with $w_i = x_i$; s is the score for the intensity of each obstacle, w is the weight, x is the ranking given by each respondent and $i=1,2,\dots,n$ stands for each respondent.

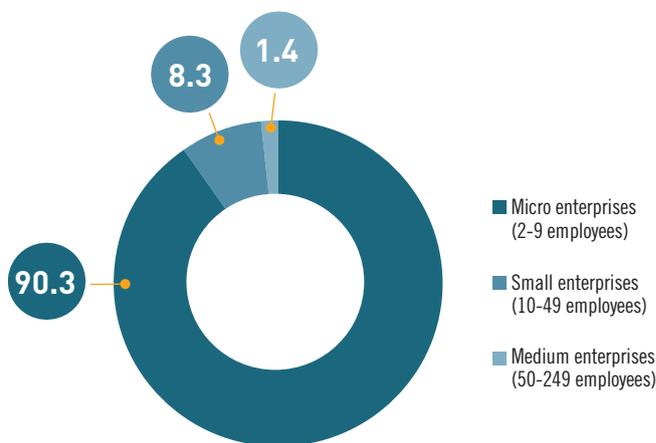


FIGURE 7. The number of appeals received and the result of the reviewing process
SOURCE: Authors' compilation based on PRB annual report (various years)

petitive practice of other competitors (with a score of 69)²⁹. The third and the fourth largest obstacles are Street crime, theft and disorder (65) and unreliable energy provision (64). The fifth obstacle is corruption (with a score of 63).

Interpreting these five barriers one can clearly see that the business environment is not conducive (note that Kosovo is ranked in lower half of countries according to World Bank's doing business indicator) and the competitive advantages of companies are not based on efficiency and productivity; they are rather based on illegal and dishonest behaviors of certain companies. This business environment coupled with weak institutional capacities (especially in judiciary system), create a fruitful soil for corruption and other malfeasance practices to flourish.

The above discussed findings suggest also in terms of public procurement, the general principles fostered by the legal framework are unattainable. These principles include cost-effectiveness and efficiency as well as equality of treatment/non-discrimination in the public procurement process.

²⁹ Anticompetitive practices refer to a wide range of business practices in which a firm or group of firms may engage in order to restrict inter-firm competition to maintain or increase their relative market position and profits without necessarily providing goods and services at a lower cost or of higher quality.

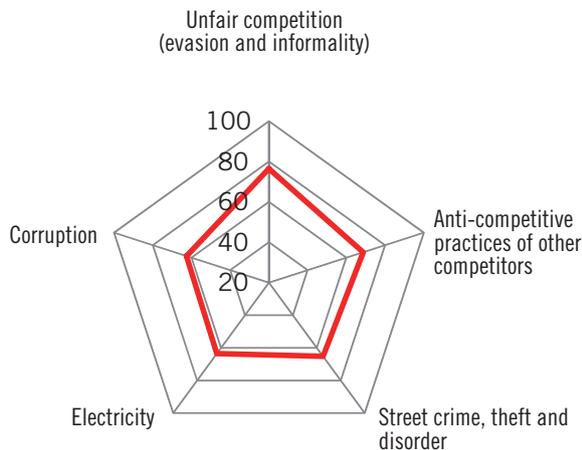


FIGURE 9. Top five obstacles faced by companies in Kosovo
SOURCE: Riinvest survey, 2011

-Proportion of companies' activity with government³⁰

Survey results suggest that, overall; there is a small proportion of companies (around 8 percent) that have the government as their client while the proportion of companies participating in the procurement process is over 13 percent. This finding should be interpreted with caution given the business structure of companies in Kosovo (majority of companies are micro size and their interaction with government is rather limited).

However, when looking in sectors in which the government is a significant client (for instance: road construction, construction and pharmaceuticals), the proportion of companies having been awarded a contract is less than 10 percent³¹ while majority of these companies (over 90 percent) participated in the procurement process. This suggests that there is a high level of concentration in the public procurement in Kosovo and only a small fraction of companies are awarded contracts. Businesses maintain that the reason for this are mainly related to close connections that these companies have with the public officials (referring to the case of non-benevolent government as being the biggest problem; i.e. the 'grabbing hand' model). According to them, these companies finance political parties and back them financially in regular basis. The awarded contracts then serve as a payoff for such support. Businesses do not rule out cases in which there is only the public procurement practitioner that is corrupted (i.e. the government representatives with political patronage are benevolent and have innocent motives).

30 Here government includes all institutions that use taxpayers' money or use PPL as the procurement framework

31 That is in value terms; in terms of number, there is a greater proportion of companies that were awarded a contract by the government but the values were rather low.

They suggest that these cases are mainly limited in small value contracts which are not attractive for 'big fishes'; i.e. the benefit of involvement does not offset the risks of being caught.

Survey results also show that in this small proportion of companies that are awarded largest share of government contracts, the share of their income coming from public funds are significant. It ranges from 30 to over 90 percent (especially in road construction sector). This reinforces the concentration argument put forward in previous paragraph. This situation produces a problem in which companies, because of being highly exposed to liquidity risks if they are not awarded contracts, have to cooperate with the non-benevolent government or corrupt procurement practitioner (jointly labeled as bureaucrats). Under these circumstances, the bureaucrats can engage in creating a hold-up problem³² in which the company has low (if any) negotiating power; hence the latter has to accept any deal set forth by the former. The bureaucrats can pressure the company for as long as the net value of the contracts (after paying bureaucrats' share) is higher than the opportunity cost of the company exiting the market. And given that the sunk costs³³ in these industries (road construction for instance), the level of extortion can be very large.

-Impediments to winning a government contract

The report also analyses the source of impediments to winning a government contracts; i.e. whether these impediments are mainly due to internal deficiencies (lack of capacities, quality, costs-efficiency, after sale services among others) or they are due to external factors. Majority of enterprises respond that the reason rests on external factors (i.e. those outside the influence of the company; and government procurement practices are labeled as the main reason). That is not to say that internal factors are not important but that in comparison with external obstacles they are ranked lower³⁴. Moreover, in an environment characterized by unfair competition from the anti-competitive practices and corruption, it is hard to build competitive advantage upon internal capacities. This in turn is creating an un-even playing ground situation which is impacting the economy at least in two ways. First it is minimizing the chances of regular companies to create competitive edge based on efficiency and secondly, as a consequence, it is incentivizing them to engage in anti-competitive practices

32 Hold-up problem is a contracting problem arising from differences in bargaining power of the parties. It is especially evident in situations when the seller (the company in this case) offers specific product/service for which the buyer (government in this case) is the only or the major purchaser.

33 Sunk cost is a cost that has already been incurred and thus cannot be recovered.

34 The reader should note that many companies responded that they lack capacities in producing an eligible tender for government contracts. In this regard, they would welcome a toolkit which would serve as a step by step procedure for producing eligible tenders.

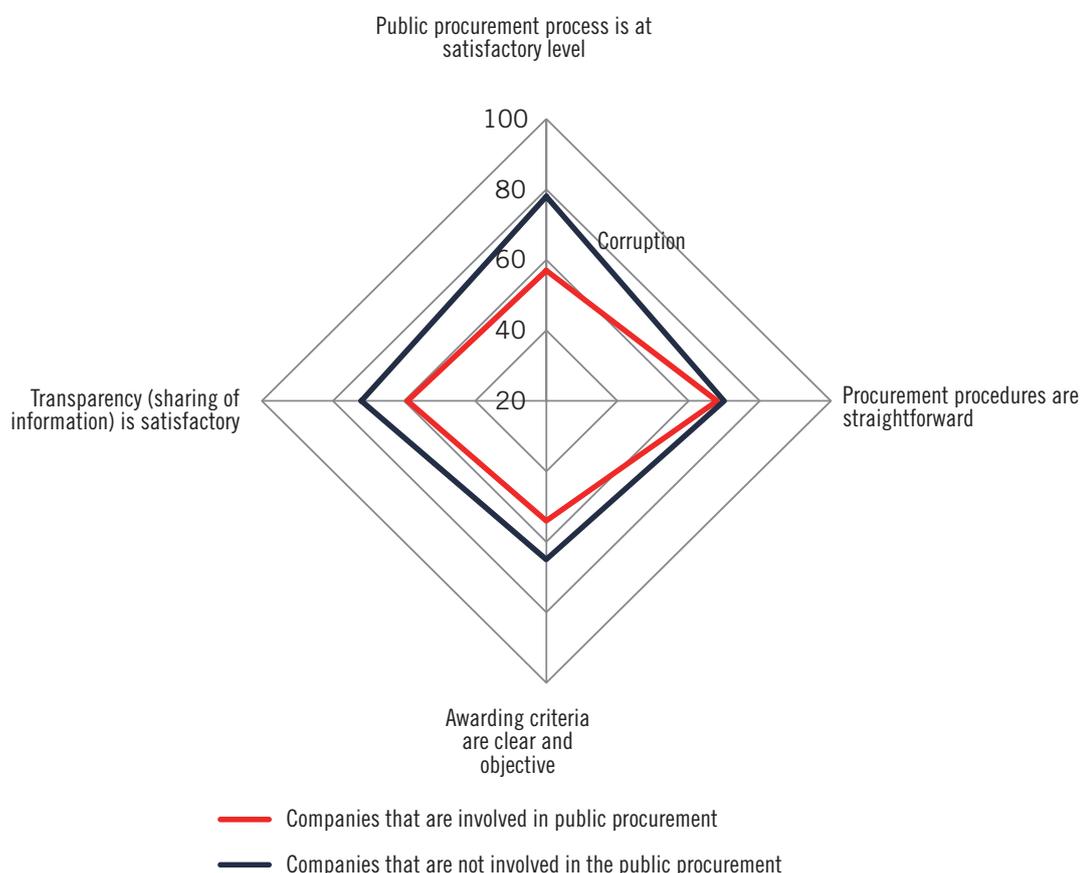


FIGURE 10. Perceptions of the procurement process (maximum score 100, indicating complete agreement)
SOURCE: Riinvest survey, 2011

as a way to survive in the market (or else they have to get out of business altogether). This problem is particularly evident in those sectors in which the government is an important client (for instance in: construction including construction of roads, schools, hospitals and health centers; provision of textbooks for students of primary education³⁵, among others).

-Various aspects of the procurement process

We next present the perceptions of the respondents about various aspects of the procurement process. The respondents were asked to express their opinion about different aspects of the process by ranking their response on a Likert scale ranging from 1 to 5. These rankings were averaged for all respondents, using higher weights for opinions expressed more strongly. The averages were then converted to an agreement score ranging, with

a maximum of 100, with 100 showing the complete agreement of the respondents with the statement. The results for a set of statements about the public procurement process are shown in the following figures.

Here, we consider two groups of statements. First, we solicit the agreement of businesses with statements related to the public procurement process (including: Public procurement process in general, Procurement procedures, Awarding criteria and Transparency); and second we focus on factors that influence the creation of an enabling environment for public procurement process to improve (including: political will, competition, trust in institutions and professionalism of procurement practitioners). In order to get a more insightful look, we have divided responses of (i) companies that are involved in public procurement and (ii) companies that are not involved in the public procurement. Emergence of distinctive response pattern might signal the difference between answers based on perceptions on the one hand and the experience on the other. Figure 10 and 11 represent the data on the two groups of statements.

³⁵ Note that government of Kosovo supplies all primary school students with free text-books and the suppliers compete in a tendering process.

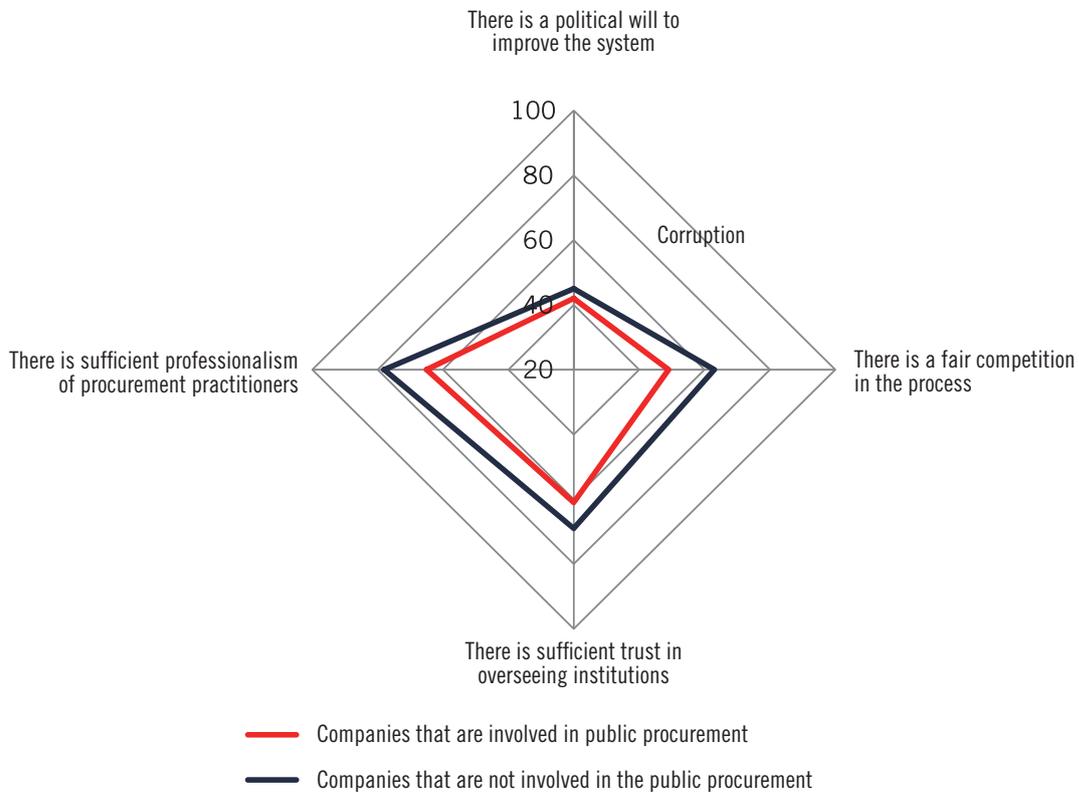


FIGURE 11. Perceptions of the procurement process (maximum score 100, indicating complete agreement)
SOURCE: Riinvest survey, 2011

At all instances, the red line (representing companies that are involved in public procurement) is closer to the origin showing lower levels of agreement (and disagreement at some instances). When asked if the public procurement process in general is at satisfactory level, companies that are involved in public procurement showed a very slight agreement (score of 57) compared to a score of 78 of companies that are not involved in public procurement. There is greater (and similar by both groups) agreement with the statement that the procurement procedures are straightforward (68 and 70 respectively). This is supported also by the findings from our in-depth interviews with some companies in selected sectors. At this point, majority of companies maintain that the selection of procedures is arbitrarily set by procurement practitioners and the use of non-competitive procedures is highly misused. Companies, in selected sectors (with high interaction with the government), maintain that government agencies use direct tendering (one source tender) in which there is no competition and the company is selected subjectively. As for the statement that the award criteria are clear and objective, companies that are involved in public procurement gave a nearly indifferent response (score

of 54; no agreement nor disagreement) compared to a score of 65 of companies that are not involved in public procurement. Companies maintain that regardless of which criteria are used, still the public procurement practitioners retain great discretion to misuse the selection (and the process in general). If the selection criteria are that the contract will be awarded to the most economically advantageous tender, companies maintain that, this leaves great discretion to the evaluation panel because it adds a lot of subjective elements to the evaluation who in turn can misuse it. In cases where the lowest price is the criterion for awarding contracts, companies report that winners of the contracts often reduce the quality of goods and services provided while there are no systematic checks over quality. Finally as for the statement that transparency (including the sharing of information) is at satisfactory level, companies that are involved in public procurement showed a very slight agreement (score of 59) compared to a score of 72 of companies that are not involved in public procurement.

Similarly, in the second set of statements companies that are not involved in public procurement show greater level of agreement.

On the statement that there is political will to improve the system, the level of agreement is similar in both groups standing at 42 and 45 respectively. The lack of political will is the common denominator of all responses as being responsible for drawbacks and the lack of improvements in the public procurement process. Companies maintain that any endeavor aiming at advancing the public procurement process is destined to fail if not coupled with credible political will and commitment. As for the statement that there is a fair competition in the process, there are differences in the level of agreements between groups where companies that are not involved in public procurement have higher level of consent for 14 points. Companies maintain that there is relatively strong competition intensity; where in most of the cases, there are over three companies that compete for a contract and majority of them are local competitors (especially in provision of goods and services; in capital investment projects and consultancy, there is an increased foreign competition). While they maintain that increased loyal competition foster efficiency, they complain that the increasing level of un-fair competition is distorting the market conditions. As for the statement that there is sufficient trust in overseeing institutions, there is a mild agreement by companies that are involved in public procurement (61) while the agreement of the other group is slightly higher standing at 69. Generally, they maintain that the level of trust in government agencies and institutions that oversee the procurement process are not at pleasing levels which, in their view, partly explains the low level of complaints that companies that are not awarded contracts put forward in Procurement Review Body. They also report that there is a risk that a company filing a complaint might get 'black listed' and will have slim chances of being awarded a contract in the future. This in turn is a great restraint for companies to come forth with complains. Lastly, there is different level of agreement (65 and 78 respectively) between two groups with the statement that there is sufficient professionalism of procurement practitioners. Companies that are involved in the public procurement process, maintain that public procurement practitioners rarely provide them with explanations when they require more information. They also maintain that the vast majority of public procurement practitioners never organize informative meetings before the bidding process so that economic operators could level the expectations (they sometimes have distorted opinions on dimensions of the contract).

Another matter is the complaint that companies that were awarded contracts have relates to the execution of payments. A lot of companies report that there are delays which create cash flow problems for them. In order to keep afloat, companies have to use bank loans or overdraft facilities which are provided, reportedly, at unfavorable conditions.

Businesses also consider that there are no mechanisms in place that would ensure the integrity of the procurement process. There is a general feeling that procurement process and the spending of public money as a result is highly misused. Findings suggest that

the public procurement is not exhibiting tangible improvements; some companies even maintain that it has deteriorated with corruption being very prevalent. The continuous rise in the level of corruption suggests that government officials have retained much discretionary power which can be misused for rent-seeking activities. Moreover it is suggested that the accountability of public officials is still low, further contributing to the spread of corrupt activities. Furthermore, the business community that is the subject to corruption hardly speaks up against these activities. Due to lack of trust in institutions, companies chose to participate in illegal practices while they report that they started to consider corruption as part of the game.

Case studies were conducted to get closer insight from companies that are highly engaged in procurement process. Their selection was intentionally non-random so that we can analyze companies operating in sectors that government is almost a monopsony (single buyer; road construction sector for instance). We have conducted three case studies: one case study for a company in pharmaceutical sector and two other case studies for companies in construction sector. The companies from construction sector maintain that process of awarding contracts in tendering processes in this sector, in most of the cases, is based on relations with the government. They also maintain that if a company chooses to file a complaint then they are 'black listed' by the respective ministry and will face huge problems in future tenders. They report that these companies in turn do not file complaints hoping not to minimize their chances in future tenders. Also, they show that tendering requirements are usually designed so that they are suitable for a particular company in order to minimize the competition. They also suggest that the quality of road construction is very low and nothing is done to prevent it. In turn companies sometimes offer abnormally low bids hampering further competition. In a similar fashion, company from the pharmaceutical sector reports that they experience huge problems in getting government contracts. They also report that filing complaints in most of the cases generates more problems than it solves. They suggest that sometimes competitors provide products with suspicious quality and therefore some contracts are awarded in conditions of an unfair competition. For a complete case studies, see Appendix 1.

SECTION 4

Views of the informed stakeholders

-Main findings

The findings from the survey were augmented by project-specific 30 interviews conducted by Riinvest team. The aim of these interviews was to identify the perceptions of the informed stakeholders about the procurement process in Kosovo. These stakeholders include: representatives of the civil society, procurement officers, representatives of central procurement agencies, and representatives of businesses.

Through the in-depth interviews with the aforementioned respondents, Riinvest analysed various aspects of the procurement process including the current legal framework on procurement, current practices in key ministries, perceptions and experiences related to public procurement in general. We again, in some cases, use the agreement score, with a maximum of 100, where 100 show the complete agreement of the respondents with the statement.

-Views on public procurement process

The results for a set of statements about the public procurement process are shown in Figure 12.

At all instances, the blue line (representing civil society organizations) is closer to the origin showing lower levels of agreement (and disagreement at some instances). They seem to have the most critical views about the public procurement in Kosovo. It is followed by the green line (representing the level of agreement of the business associations) and finally the red line (representing the level of agreement of the procurement officers and central procurement institutions) who show the highest level of agreement, i.e. have less critical opinions.

As for the credibility of the procurement process respondents give different reactions. Among the procurement officers there is relatively strong agreement with the statement that the process is credible (a score of 83) whereas business associations have milder agreement of 67 while the civil society representatives tend to disagree with a score of 45. In terms of transparency of the procurement process, there seem to be similar response from

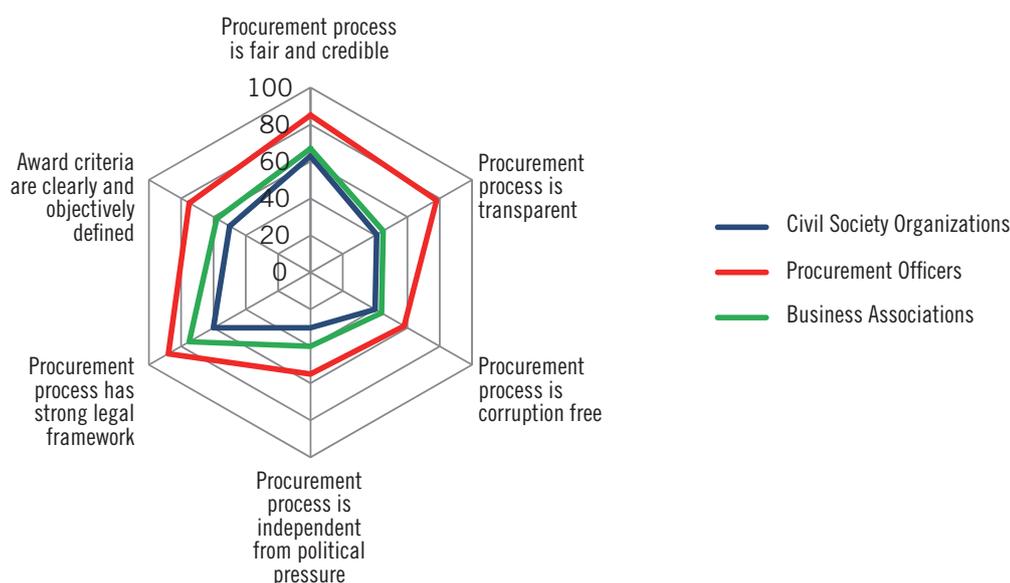


FIGURE 12. Perceptions of the informed stakeholders about the procurement process in Kosovo (maximum score 100, indicating complete agreement)
SOURCE: Authors' compilation based on project specific interviews

civil society representatives and business associations (41 and 45 respectively) compared to a stronger agreement among the procurement officers (with a score of 78). The latter maintain that the transparency in the process is maintained by the legal requirements.

As for the procurement process being corruption free, responses are quite similar. There is some mild agreement among procurement officers (58) while business associations and civil society representatives tend to disagree (44 and 40 respectively). Similarly on the statement that 'procurement process is independent from political pressure', all the respondent show less agreement; with civil society representatives showing strong disagreement (with the score of 30) compared to business representatives (with a score of 40 and procurement officers 55). Conversely, as for the legal framework of the procurement process, there is strong agreement among public procurement officers (88) compared to representatives of the civil society organizations (75) and business representatives (70). Despite differences in the level of agreement, responses still fall in the middle half or upper quartile of the distribution.

Finally, on the criteria set for awarding contracts, there was less agreement among representatives of the civil society (50) and business representatives (58) who are less supportive of the statement compared to public procurement officers (with a score of 75).

-Involvement of independent parties in the amending legislation

The report further considers the level of involvement of the civil society and other independent parties (including the private sector representatives) in drafting and amending legislation related to public procurement. There are different views on the matter. While the representatives of the central procurement authorities claim that the process is open and welcomed to everyone, others claim that there is no sufficient information about the process, hence the level of involvement of independent parties is said to be rather limited. Some representatives of the civil society maintain that there is a lack of expertise among the civil society organization related to public procurement. In their view, this process is highly technical and as such it requires sufficient technical background knowledge for someone to be involved in proposing legal amendments. They suggest that if the trainings for public procurement were to be offered to other parties (apart from the procurement officers), then they would be more informed and act as more competent watch dogs for the government.

-Views on tender procedures and evaluation criteria

We further scrutinize the satisfaction of different stakeholders with tender procedures used by contracting authorities. As expected, public procurement officers claim that the procedures used foster competition which is not supported by the representatives of the civil society and those of the business associations. While the increased use of open procedures indicates some improvements, still the use of non-competitive procedures remain high signaling retained discretion of procurement officers who can in turn misuse it. Especially the use of single source tendering (even though it dropped in recent years³⁶) raises concerns of hindered competition. The latter method was highly criticized by independent observers (including the EC progress report).

As for the evaluation criteria, the procurement officers indicate that the lowest price criterion makes the process more straightforward though they acknowledge that the limited capacities for ex-post evaluation of delivered products and services make this method very vulnerable to manipulations. Similarly, other respondents suggest that, while the lowest price is expected to increase the objectivity in selection, it still has problems related to selection of some types of contracts (especially services) where it is very hard to make objective comparisons based only on price. Also, the possibility of compromising the quality and engagement in corruption in ex-post phases of the process raises the concern of these respondents. Respondents argue that companies that cannot deliver the product/services at agreed quality should be penalized. As for the specifications in the tender dossier, apart from public procurement officials and representatives of central procurement institutions, others affirm that they are not clear and that they favor particular company, i.e. the winner, in a lot of cases, is determined beforehand.

As for the appropriateness of publicizing the procurement contracts, there is a general agreement that with the last set of amendments, there were significant improvements in this regard. The last set of amendments does not require from contracting authorities to publicize contracts in daily newspapers (though it does not prohibit it). Previously, businesses had to buy all newspapers in order to be able to track tenders. Having all of them in one place makes the process much more convenient.

-Views on the impediments to winning contracts and compliance with public procurement procedures

In terms of obstacles to winning contracts from contracting authorities, two groups of impediments are identified. Those that are internal to companies mainly related to producing an

³⁶ Refer to previous sections for details

eligible offer and those that are external to companies that are mainly related to un-competitive behavior of firms and corrupt behavior of officials. As for the first set of obstacles, respondents suggest that more training should be offered to private sectors either by KIPA or other independent institutions. Respondents (especially the business representatives) claim that they would welcome a toolkit which will be a step by step guide to preparing bids for government contracts. As for the external obstacles, especially the business representatives and those of civil society organizations maintain that corruption is widespread in public procurement and as such it is creating a non-competitive marketplace sponsored by the state. In turn this setting is hampering competition and driving companies either out of the market or incentivizing them to get into informal sector (or follow un-competitive behaviors themselves).

The government agencies (mainly procurement officers in contracting authorities) respond that the level of compliance with the public procurement procedures stands at a satisfactory level though they acknowledge some level of bureaucracy; which is attributed mainly to the legislation. They maintain that the legal framework lacks flexibility and as a consequence they are forced to do small administrative violations. These violations in turn are used as an extorting tool by their administrative and political superiors. In large they consider that the procurement process is fair and credible and awarding criteria are set in objective manner. However, they admit that the procurement process in Kosovo is exposed to the pressure from the directors of government agencies who insist that certain contracts are awarded to particular company. And, because there is lack of trust in judiciary system and anti-corruption agency, the procurement officials are reluctant to report those cases. They also report that companies seldom complain when they are not awarded a contract which is also related to their expectations and lack of trust in institutions. Even though the legal framework has been amended, majority of procurement officials interviewed did not have sufficient information about these changes despite the fact that there are continuous trainings provided by the government and that they undergo a relicensing procedure every third year. Representatives of the Central Procurement Agency noted that current structure of the central procurement institutions is not common in other countries. In their view, this lowers the responsibility as it is dispersed in two other institutions (Public Procurement Regulatory Commission and Procurement Review Body). The head of CPA can only be elected for a 3 years term with no right for re-election. On the other hand, board members (who are mainly appointed by political circles and in general have no prior experience with public procurement and are not acquainted with CG principles) are elected for 5 years term and have right for re-election. In their view, this should be changed so that the head of CPA can be re-elected in order to attract more professionals for this position. On the other hand, the representatives of the Procurement review body suggests that the current legislation has facilitated more smooth procurement

process though they complain as not having sufficient capacities to deal properly with all complaints that are filed at this institution from different companies. Similar worries were raised by the EU progress report which shows that the way in which the complaints are handled is not at a satisfactory level.

In contrast, business associations and civil society representatives report that the integrity of procurement process in Kosovo is highly questionable. They argue that there is huge political pressure by government officials towards the procurement offices though there are many cases when there is voluntary cooperation between the two. Equally, there is a low level of accountability which creates a fruitful soil for corruption to flourish. Civil society representatives suggest that awarding criteria are subjective and leave great deal of discretion to the government officials. Also, they suggest that the level of transparency is very low. On the other hand business associations suggest that businesses are constrained by the way in which the procurement process works which hampers competition at all instances.

-Summary of the conference proceedings

Riinvest Institute with the support of CIPE organized a conference focusing on the public procurement process in Kosovo. This conference presented the views of the relevant actors in the public procurement process including, inter alia: the central institutions of public procurement, parliament, government, civil society, business representatives and the media. At the inception, Riinvest representative presented in great length the findings and recommendations of their research report. It was followed by discussion from panelists and other participants at the conference. Apart from Kosovar experience, regional and global experiences were presented as well. The conference was held in Prishtina on the 5th of April 2012 and was attended by over 60 participants. **Key messages of the conference:**

1. **First**, the findings and the recommendations of the Riinvest research report presented at the conference were validated en bloc by all participants.
2. **Second**, representatives of central procurement institutions (PPRC, PRB), supporting institutions (CPA, KIPA) and the parliament expressed their readiness to coordinate efforts in fostering more transparent and efficient public procurement process, jointly with other stakeholders present at the conference (civil society organizations, media and business representatives). All panelists acknowledged the fact that this conference was the first occasion in which all relevant actors were brought together. As such, all agreed to use it as a solid platform for fostering more efficient and more transparent public procurement system.
3. **Third**, experiences from Albania and Macedonia showed that there are some great challenges related to establishing the e-procurement system. It was suggested that a lot should be done in: (i) setting the e-procurement infrastructure (ii) training public procurement officers, (iii) providing training for businesses. Representatives from Macedonia proposed establishing a regional initiative that will be used as a platform for exchanging experiences given that the public procurement process in these countries is in similar stage of development.
4. **Fourth**, all actors agreed that the working group in charge of legislative improvements on public procurement should be opened up so that it includes other stakeholders as well. Head of PPRC promised greater involvement of other actors in the process; especially to ensure greater participation of the civil society organizations and business representatives.
5. **Fifth**, it was suggested, by other participants, that the competences and responsibilities of (i) public procurement officers, (ii) administrative superiors and (iii) political superiors should be defined more clearly as there are some ambiguities in the current legal framework. These suggestions were welcomed by representatives of the PPRC.
6. **Sixth**, all representatives agreed that KIPA and other inde-

pendents institutions should increase capacities so that they can offer training on public procurement not only to public procurement officers but also to businesses, media representatives, representatives of civil society among others. It was also suggested that providing a toolkit for companies as a step by step guide to produce eligible tenders would be welcomed, especially by businesses.

7. **Seventh**, the conference benefited greatly from the presentation of the CIPE representative who shared with participants the experiences from different parts of the world.
8. **Eighth**, the Chairman of the Oversight Committee on Public Finance from the Kosovo Parliament ensured that they are increasingly seeking more accountability from PPRC, General Auditors Office and the Government in general to ensure a more efficient and transparent use of public money. He also offered support for Riinvest in future activities related to this topic.
9. **Finally**, the event attracted great attention from the media. It was recorded by BIRN, to be broadcasted in a special edition of their show 'Life in Kosovo'. Parts of the conference were reported in the news by all major national TV stations and newspapers. The lead researcher participated in three interviews on national TV stations.

Panelists:

- Mr. Sejdi Osmani – President of Riinvest
- Mr. Alban Hashani – Research Director, Riinvest
- Ms. Anna Nadgrodkiewicz – CIPE
- Mr. Ali Sadria – MP, Chairman of the Oversight Committee on Public Finance
- Mr. Safet Hoxha – Chairman, Public Procurement Regulatory Commission
- Mr. Mursel Rraci – Chairman, Central Procurement Agency
- Mr. Ekrem Salihu – Board member, Procurement Review Body
- Mr. Ilaz Duli – Board member, Public Procurement Regulatory Commission
- Mr. Gjergji Moçka – Public Procurement Agency of Albania
- Ms. Aneta Mostrova – Public Procurement Agency of Macedonia
- Mr. Fidan Kalaja – FOL – Civil Society Organization
- Ms. Lumnije Ajdini – Kosovo Alliance of Businesses
- **Moderator:** Muhamet Hajrullahu – BIRN

-Conclusions

This study is an analysis of the challenges towards reforming public procurement system in Kosovo and the shortcomings in the implementation of the law. Using primary and secondary data it reviews the forwards and backwards in the process of establishing this system. Findings of this research suggest that, despite evident advancements in this field, a lot remains to be done in the future especially in ensuring proper implementation of legal provisions. Public procurement as major drivers of Kosovo's economy must be done efficiently and transparently in order to provide a level playing field for all actors involved and help governments to get the best value for taxpayers' money. The public procurement process in a country is an essential determinant of the success of promoting competition and private sector development, strongly influencing economic growth, job creation and standard of living. Therefore reforms that aim at the development of transparent and accountable public procurement process which encourages competition, efficiency and sustainability of companies should be high up in the priority list of governments.

Research finds that the public procurement system in Kosovo has achieved considerable progress despite being very new. In spite of the inception challenges it was able to draw from experiences of other countries and enjoy the technical support of many international experts who were engaged in this process. Currently, the legal framework is mainly in line with directives of the European Union. However, public procurement officers complain that the law lacks the flexibility to accommodate different requirements of contracting authorities. The secondary legislation is largely completed but complicated. Advancements made in the legal segment tend to share responsibilities between public procure-

ment officers and their administrative and political superiors. However, this responsibility balancing system is limited to large value contracts. Current legal framework also opens the door for e-procurement which is still at its inception phase.

The use of framework contracts and centralized procurements by contracting authorities has increased though not at satisfactory levels. Open procedures account for over 80 percent of total value of signed contracts. The level of single source tendering has decreased after reaching alarming levels in 2008 however it still remains at around 7 percent. As for the contract award criteria, lowest price criterion continues to dominate the overall value of total number of contracts. The remaining contracts are awarded based on most economically advantageous tender (MEAT) criterion. Big concerns remain about the objectivity of contract award criteria.

Level of competition in the procurement process has exhibited a slight decrease during the last year. The average number of companies bidding for a tender has dropped by around 13 percent. Our survey findings suggest that companies have started to lose trust in the process hence they are self-selective in bidding. They maintain that in a lot of cases the winner is known once the invitation for bid is published therefore they chose not to participate. The proportion of foreign economic operators winning public contracts has increased in recent years. There is high proportion of tenders that are cancelled. On average around 35 percent of contract notices are cancelled on different grounds. This gives rise to big concerns. The number of appeals that Procurement Review Body received during the last year has increased.

Companies complain that tendering procedures and paperwork is very complicated and sometimes they get disqualified due to non-technical compliance with the requirements. Survey results suggest that the business environment is not conducive and the competitive advantages of companies are not based on efficiency and productivity; they are rather based on illegal and dishonest behaviors of certain companies. This business environment coupled with weak institutional capacities (especially in judiciary system), create a fruitful soil for corruption and other malfeasance practices to flourish. Results suggest that there is a high level of concentration in the public procurement in Kosovo and only a small fraction of companies are awarded contracts. Majority of enterprises respond that the reason for not being awarded contracts rest on external factors (i.e. those outside the influence of the company; and government procurement practices are labeled as the main reason). However they also acknowledge that there are internal obstacles as well. The latter, are mainly related to producing an eligible offer.

Results suggest that the lack of political will is the common denominator of all responses as being responsible for drawbacks and the lack of improvements in the public procurement process. Businesses suggest that the government is captured by companies and other interest groups who finance their political parties and back them financially in regular basis.

Businesses and civil society organizations consider that there are no mechanisms in place that would ensure the integrity of the procurement process. Majority of actors share the opinion that the working group in charge of legislative improvements on public procurement should be opened up so that it includes other stakeholders as well.

This research recommends that the central procurement institutions should ensure better compliance of the PPL with EU directive and good practice and to secure its solid anchorage among the key stakeholders. They should promote centralized procurements and address urgently the lack of secondary legislation and design advisory support to facilitate the application of the law by contracting entities and to increase the understanding of economic operators. The implementation of e-procurement and e-auction infrastructure should be fast-tracked and more training should be offered to private sectors either by KIPA or other independent institutions.

Government should make efforts to improve the business environment so that it encourages the development of competition in the domestic market. It should also have a higher degree of integration of procurement process into the overall public expenditure management process. Donor community should continue to support institutional development of central procurement institutions. Opposition parties and civil society organizations should, in turn, actively seek from the government to improve the public procurement system by increasing the public pressure and be more active in monitoring and signaling malfeasance in the public procurement process as well as come forth with recommendations on improving the system. Finally, the parliament, should be more active in holding the central procurement bodies as well as the government accountable for implementation of law. It should also engage other stakeholders in parliamentary hearings in future legislative amendments.

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-Appendices

Appendix 1: Case studies

CASE STUDY ONE

The sector of road construction is regarded as one of the most corrupted sectors in the country. In the last two years, the Government has invested huge amounts on road construction and very often there have been accusations for corruption and nepotism. The Ministry of Transport is under investigation on suspicion of misuse of tendering rules; following an EULEX visit on April 28, 2010. The Ministry is suspected among others of giving tenders to companies that do not meet the tendering requirements, including here the technical criteria.

We have interviewed a company that is 100% dependent on the tenders, from either local or central government, with the intention to get information regarding the public procurement from their perspective. The first company subject of our study, in the fiscal year 2010/2011 had a turnover of approximately €2 million. Such rate generally falls under well established firm, and this is important for the validity of findings from the study. Moreover, given the importance of public tenders for its operation the perceptions of this firm are particularly important. As argued, the government represents a monopsony

We never complain as government will punish us in the future bids. We know of several cases when our competitors once complaining were never able to win a tender again

for this firm and the specific significance of the firm is also argued by the ranking of the government for the existence of the firm with intensity of 10 (out of 10). With the government as their only client, this company admits that doing business is very difficult since they face various obstacles in the tendering process; and which in many cases are unequally applied to competitors. In this regards, the presence of unfair treatment hampers considerably the efficiency of well established businesses on the burden of firms that are closely linked and tied to public officials and decision-makers. Given the big nature of the firm, tenders with a greater monetary value are of higher interest for the firm. Such tenders tend to attract fewer bidders, but are subject to more exhaustive requirements, and hence carry more potential for unfair treatment by decision-makers. For instance, the average numbers of bidders, as declared by the firm ranges from 3 to 9 companies.

In addition, presence of corruption is seen as top barrier in correct treatment. Corruption also hampers transparency and information sharing to bidders that have been rejected or not selected for the process. They say that companies do not feel free to complain when they do not win the tender since they believe that in most cases the companies that complain lose their

chance to succeed in the future and they also do not believe that the complaint procedure is useful since they believe that the Government will always find something to reject you if they want to and unfortunately there are no mechanisms that would prevent the violation of the integrity of the process. The fact that firms do not feel free to file a complaint is very concerning and this makes it obvious how non-transparent this process is.

Partially, the lack of companies to comply with procedural requirements appears also to be of specific importance. The company admits that there were cases when they could not get the tender due to the fact that they failed to bind all the necessary documents; as were the cases when companies that won the tender but were favored passed without complete documentation. Double standards for firms also represent an important indicator of unfair treatment.

Firm also believes, the Public Procurement Regulatory Commission (PPRC) is the institution which: should make sure that the Law on Procurement is respected; makes sure that the system of public procurement is rational efficient and transparent by encouraging competition and respecting the equality of participants in the procurement process; gives advice to all contracted authorities and economic agents on implementation of provisions of the law. This Commission is also responsible for the possible complaints that come from the economic agents regarding the

tendering process. As stated by the interviewed company, the Commission is not transparent and fair when processing the complaints that come from firms regarding the irregularities that they face during the tendering process.

It is obvious that the companies engaged in public procurement face various problems that come as a result of the mismanagement and circumvention of the rules and procedures. The negative occurrences like corruption, nepotism and unreal competition that have been identified as present in the public procurement process force firms to undertake actions that they are not proud of. This is more serious in the cases when the firms have only the local or the central government as their client. These firms are very sensitive and they need to make sure that they have very strong relationships with the key factors inside the institutions or otherwise they are threatened to go out of the business. Therefore they are involved in corruption which as a result leads to offering a very poor quality services. On the other side, there is no one in the institutions that would question the quality provided by the firms since they are both involved in corruptive affairs. This consequently leads to very poor quality services and also a very uncertain business environment for the firms.

CASE STUDY TWO

Following the interview from case study one, we have interviewed another company in road construction sector. The company subject of our study has only 42% of its revenues generated from government tenders, and compared to the previous case study our subject is less dependable on governmental work; hence might view obstacles with less intensity.

The company's revenue for the 2010/2011 fiscal year has been approximately €2 million, which amount once more reflects the validity and the importance of this company in the market. Moreover, being in same range with previous company, this subject allows us to further investigate differences in spite of same firm characteristics.

Even though in this case the government constitutes less than 50% of the revenues of the firm, they still ranked the Government as very important for the firm's existence with intensity 8 (out of 10), but still lower as compared to the previous case study where the importance was rated with 10 (out of 10). Understandably companies that have diversified the sources of their income are less dependable on one specific source as is the case now with our subject. This company like the one in the case study one acknowledges that they face various problems during the tendering process. They assess the bidding process to be very corrupted, highly affected by nepotism and unfair competition. These barriers were similarly observed in our previous case serving thus as robustness of the findings. In addition, firm representatives admit that there were cases when they were not able to win the tender but this came as a result of the fact that they were not able to offer the lowest price while this was one of the conditions in these cases. It is interesting that although recognizing the presence of corruption and nepotism, in this case the direct experience as declared in the previous case is missing. Moreover, our subject argues that they have never filed a complaint, but if they were to do so, they could be discriminated later. Post-complaint discrimination appears to be a major cause

for firms hesitation to address irregularities. However they think that there are several mechanisms that would prevent the violation of the integrity of the process but the existing mechanisms to monitor the process of public procurement are weak.

The company always bids for open tenders from the Government but they are not satisfied with the tendering procedures used in the country. This way they assess this process with intensity 5 (out of 10) but again, compared to our previous case (4 out of 10) the intensity is rather lower supporting thus the claims of positive relationship between non-dependence and barriers. Beside percentage of dependence, another explanation behind lower intensity estimation of barriers could be that the current firm although big, it mostly aims at tenders with a lower monetary value hence facing lower levels of barriers and requirements from institutions. Note that these requirements always serve as transaction points and opportunities for unfair treatment towards businesses.

Differences in size of tenders and differences in dependency may also be reasons why current firm assesses the transparency of the tendering process with intensity 6 (out of 10) and in comparison with the firm in case study one which assessed this process with intensity 2 (out of 10) it imposes huge difference in opinion.

The differences in assessment between two companies that operate in the same sector make once more obvious the differences in treatments, transparency and requirements by institutions. The very rigorous and exhaustive requirements are not applicable for all the firms making this way the survival in this sector very hard for some firms. The finding that one company believes that there are mechanisms that monitor the process while the other firm rejects the existence of such a mechanism reflects the uneven treatment of the firms by the authorities.

A major change is needed in order to improve drastically the current process of public procurement. Without a serious fight on corruption, nepotism and unfair competition, little can be expected



This study is an analysis of the challenges towards reforming public procurement system in Kosovo and the shortcomings in the implementation of the law. Riinvest Institute with the support of Center for International Private Enterprise (CIPE) has launched a comprehensive analysis which covers the most important dimensions of this process. This study solicits the views of all relevant stakeholders including among others: the central procurement institutions, parliament, government, private sector, civil society and media. Public procurement makes up close to one fifth of Kosovo's GDP and thus is one of the major drivers of its economy. Therefore, it must be done efficiently and transparently in order to provide a level playing field for all actors involved and help government to get the best value for taxpayers' money. Public procurement process in Kosovo has marked evident advancements, especially in the legal and institutional infrastructure, however the implementation of the law remains a big challenge. The public procurement in Kosovo, from the majority of actors involved in our research, is perceived to have been tainted by corruption. Therefore it is recommended that institutions and mechanisms that ensure the integrity of this process are strengthened.

Riinvest is committed to play an active role in publicizing the importance of a sound public procurement which promotes fairness, efficiency and minimization of corruption and misuse of taxpayers' money while it maximizes the economic and social gains of public procurement. We would like to thank CIPE very much for supporting this research and related activities and for their continued cooperation during the realization of this project. We would like also to thank managers and business representatives, official of the institutions, representatives of media and civil society for their cooperation during the implementation of our research. Riinvest wishes to thank all parties involved in preparation of this report for their contribution while it assumes the sole responsibility for findings and conclusions of the report.