

Section 11

The Institutional Structure for Government Procurement:

An Initial Look at the Emerging Chinese Model

by Daniel Jay Mitterhoff (May 1999)

Recently, China has made substantial progress in developing the foundations of a modern public procurement system. This progress is a logical development of China's adoption of market economy mechanisms, in conjunction with the traditional socialist orientation of its economy. China's reforms have moved further, allowing the actual government, not just enterprises, to become purchasers in the market and obtain the benefits of the market. Moreover, the government, as purchaser, presents enterprises with a new and substantial customer base. This is a truly new economic role for the government in the economy, which complements the State's role of macro-economic regulator and owner of state enterprises.

"Government Procurement" refers to the government's purchasing of goods and services on the open market. China's own scholars recognize that this has become the prevalent method by which administrative organs of developed countries meet their mate-

rial needs^①. It is predicted that China's public procurement will eventually reach the level of 10% of China's Gross Domestic Product, as it exists in other countries.^② This trend will only be furthered by China's ultimate entry into the World Trade Organization and its subsequent accession to the World Trade Organization Agreement on Government Procurement.^③

To change the way government agencies provide for their material needs requires a change in budgetary and legal systems to facilitate more cost effective purchasing and prevent waste and abuse. China is moving away from a system originally regulated under the auspices of the Purchase Control Office (Kongzhi Goumai Bangongshi), where less concern was placed on the quantity or quality of purchases, but rather on whether an agency purchased at all. Instead, China is now emphasizing quality purchases by the government. China is building a framework where proper budgetary controls will be instituted, and where getting the best materials and services for the best price will become the new yardstick for measuring the system. The series of lectures being presented at this symposium are designed to address the best way to build this new system. The contribution of this paper is to provide an American perspective on the subject.

① Zhang Hong Li, "Certain Questions About the Establishment of China's Government Procurement System," *Guanyu Jianli Zhongguo Zhengfu Caigou Zhidu de Ruogan Wenti*, "Xin Hua Wen Zhai", No. 9, pages 54-55 (September 15, 1999).

② Id.

③ Chu Ren "A Legislative Inquiry Concerning Our Country's Government Procurement Law", "Guanyu Wo Guo <Zhengfu Caigou Fa> de Lifa Tanta", *The Journal East China University of Law and Politics*, *HuaDong Zhengfa Xueyuan Xuebao*, No. 4, page 70, (July 20, 1999).

At its core, a public procurement system is derived primarily from two government activities: (1) The budgeting and distribution of public funds in order for government agencies to purchase goods and services, including construction; and (2) the actual implementation of purchasing activities. While these activities are obviously interrelated, they sometimes operate at cross-purposes. The budgetary end wants to ensure that government agencies purchase the best quality goods and services at the best price. To meet these goals, the budgetary component favors, for example, systems which promote fair and open competition - in other words mechanisms which produce high quality goods and services at low cost.

The implementing end shares these goals, but also strongly values the speedy and efficient provision of goods required for the operation of the agency's political mandate. The procedures which ensure a competitive environment (the budgetary considerations) often impair the efficiency sought by the purchasing agency. One challenge facing all modern public procurement systems is finding a balance between these

sometime competing goals.^①

One method of structuring the institutions of a public procurement system is by doing so along functional lines, finely separating the implementation organs from those institutions performing a supervisory role over the proper use of public funds and the adherence to the social and political goals of the system. Of course, this separation cannot be an absolute separation of functions since they are both integral parts of the whole system. Rather it provides a theoretical basis for defining the legal relationship between the supervisory organs and the practical procurement departments which implement purchasing activities.

This theory of separation of functions has already been articulated by Mr. Zhang Hong Li in his article entitled "Certain Questions About

① Moreover, this tension is exacerbated by political and social goals which also mandate the use of certain purchasing procedures. For example, the political goal of preventing corruption requires the use of restrictive mechanisms in carrying out purchasing activities. Thus, one finds that many procurement systems, including China's, require that bids on public projects be opened only in public and confirmed by a notary. Such a public opening of bids for each and every substantial purchase burdens the agency in ways not shared by private enterprises. Nevertheless, the system will bear this inefficiency for the greater good of preserving the fairness and openness of the system. Similarly, in the United States, there are laws which pursue the social goal of giving disadvantaged and minority owned businesses an opportunity to participate in public procurement projects. Accordingly, there are what are called "set-aside" programs which require certain projects or portion projects to be contracted out only to these disadvantaged and minority owned businesses. These programs, although serving a worthy goal, burden the relevant agencies with ensuring they meet the required set-aside quotas and sometimes even diligently searching for contractors who meet the status of a disadvantaged business. Again, the efficiency of the system is subordinated to these higher goals.

the Establishment of China's Government Procurement System".^① Mr. Zhang describes a system where the supervisory agency, as represented by the Ministry of Finance and its departments, perform certain functions separate from the procurement implementing agencies. Under the formula described by Mr. Zhang, the Ministry of Finance is responsible for drafting up regulations on government procurement, setting procurement policy, setting long term procurement plans, circulating procurement information and statistics, and the training of officials. The departments of the finance ministry, in turn, are to approve the qualifications of both suppliers to the government and the intermediary agencies carrying out tendering and bidding activities. The finance departments are also to engage in budget planning activities, set the catalog of items for procurement, and receive and review complaints about the procurement process.^②

In contrast, the functions of the procurement organ are to implement the system through organizing large scale procurements and representing other government agencies in procurements by providing uniform procurement services. Mr. Zhang notes that the supervisory agencies should not take part in any procurement implementing activities, although he recognizes that some overlap is presently occurring in order for officials to secure the necessary training.

The discussions at the symposium reflect a general consensus that the Ministry of Finance should be the lead agency for supervising gov-

① See footnote number 35.

② Note that in the U.S. system, the qualifying of suppliers to the government is a function carried out by the implementing agencies, not the supervisory agencies. Contractors are qualified with respect to individual purchases.

ernment procurement. There is a recognition that government procurement is a critical element of the public budgeting process in which the Ministry of Finance has a critical role to play. However, with respect to the responsibility for the implementation of purchasing activities by the government, the consensus at the symposium weakens. While the symposium participants generally subscribe to the notion that the supervisory functions and implementing functions of government procurement need to be separated, there is disagreement as to whether these activities should be separated along institutional lines as well. Some believe that all the functions of government procurement should be administered under the Ministry of Finance, yet separated by department, while others believe that the supervisory function should be left under the auspices of the Ministry of Finance and the implementation functions should be delegated to an agency or agencies completely separate from the Ministry of Finance.

The United States system separates supervisory and implementing functions along both functional and institutional lines. In the U. S., this complete separation is natural given the three branch structure of the U. S. government. In the U. S., Congress has the power over national expenditures and the President has the power to implement most procurement activities. Therefore, an agency of the Congress, the "Office of the Comptroller General of the General Accounting Office", has supervisory authority over many aspects of the procurement process. This office has broad investigative functions related to the receipt, distribution and use of public funds. It also has the power to evaluate purchasing programs, has access to all government records, provides advisory opinions on agency expenditures, and can audit projects. It also hears bid protests of disappointed bidders.

The executive agencies in the U.S., however, are the institutions responsible for carrying out specific purchasing activities, which include the implementation of bidding procedures, the daily management of procurement contracts, and presenting reports on their procurement activities to the Office of Comptroller General and higher level executive agencies. Most executive agencies carry out their own individual procurement activities, so purchasing is largely decentralized.^①

At the symposium, the debate over whether China's procurement system should be centralized or decentralized continued throughout the course of discussions and remains unresolved. Concerns over the control of government purchasing, the proper expenditure of public monies and the prevention of corruption lead some participants to support a centralized system, while other participants find a centralized system too cumbersome risking an impairment of efficiency and intra-governmental disputes among the central procuring authority and the end-user government agency. Still others find an evolving system from centralized to decentralized attractive because it provides time to experiment with methods, train government officials in proper procurement implementation, and improve the overall system in a centralized structure before empowering individual agencies to conduct independent purchases in a decentralized system.

Despite the debate at the symposium, the current Ministry of Finance on government procurement and various local legislation clearly point to China developing a centralized system for government procure-

^① An exception in this decentralized system is the United States General Services which handles real property purchases and leases on behalf of various civil agencies, or may handle purchases which benefit multiple agencies.

ment, with the establishment of a Government Procurement Center to handle purchases on behalf of other government departments.^① These regulations and local laws also generally authorize the Government Pro-

① The rest of the discussion in this paper follows from the structure of government procurement currently set out in China's local laws and other regulations. For example, see Ministry of Finance "Provisional Management Measures On Government Procurement" issued in June 1999 and "Shanghai City Measures for the Management of Government Procurement" issued in December 1998.

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(续下)

curement Centers to employ^① the services of non-governmental Tender and Bidding Companies to organize the bidding activities on individual projects. Therefore, China, in establishing its new procurement sys-

① (接上)Id.

Chu Ren "A Legislative Inquiry Concerning Our Country's Government Procurement Law," "Guanyu Wo Guo <Zhengfu Caigou Fa> de Lifa Tanta," The Journal East China University of Law and Politics, HuaDong Zhengfa Xueyuan Xuebao, No. 4, page 70, (July 20, 1999)

Moreover, this tension is exacerbated by political and social goals which also mandate the use of certain purchasing procedures. For example, the political goal of preventing corruption requires the use of restrictive mechanisms in carrying out purchasing activities. Thus, one finds that many procurement systems, including China's, require that bids on public projects be opened only in public and confirmed by a notary. Such a public opening of bids for each and every substantial purchase burdens the agency in ways not shared by private enterprises. Nevertheless, the system will bear this inefficiency for the greater good of preserving the fairness and openness of the system.

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tem, ① must not only define the relationship between the supervisory organs and the implementing organs, but must also define the relationship among the three implementing institutions.

The Government Procurement Center will be the lead agency in the early stages of purchasing activities, particularly in determining the procedures to be used in purchasing items - such as open bidding - and overseeing the implementation of these procedures. However, after the successful implementation of bidding, the leadership role of the Government Procurement Center in the management of the procurement contract is less clear.

The current regulations on government procurement suggest that the supplier will enter into the procurement contract with the individual government organ utilizing the purchased goods or services, not the Government Procurement Center. Therefore, at the contract management stage, the role of the Government Procurement Center must necessarily shift to a supervisory role over the individual agency's contract management. As a result, Chinese law and practice will have to accommodate and rationalize the differing supervisory roles of the Ministry of Finance and the Government Procurement Center at the contract management stage, or the Center can be removed from any role in con-

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tract management, simply leaving the Finance Ministry as supervisory organ, and the individual agency as contract manager. Alternatively, the Center could maintain its leading procurement implementation role by entering into and managing the contract with the supplier, on behalf of the individual agency. This, in turn, relegates the individual agency to a non-active role in contract management. In either case, the key is to clearly designate the agency which will be the ultimate authority in the management of the contract, and the characteristics of the subsidiary role played by other interested agencies.

Experience in the United States has revealed that adherence to strict roles and procedures in the management of public procurement contracts is just as important as the use of strict procedures at the contract formation stage. Accordingly, the United States have built many control mechanisms into the performance of government contracts. These control mechanisms are grounded in the designation of certain officials as Contracting Officers. Only the Contracting Officer has the power to bind the government contractually and to make other important decisions on behalf of the government in the contracting process. Moreover, the contract management system is driven by prescriptions to the Contracting Officer. The applicable regulations direct the Contracting Officer on how to proceed at each stage of contract management, and also prescribe how to handle specific problems encountered during contract performance. The role of the Contracting Officer lends certainty to the system by creating a focal point to the system for both the contractor, who knows who is the decision-maker on the contractor, and for the supervisory agencies who know the exact official responsible for the contract.

Similarly, for China, it is important to fix the office which bears

ultimate responsibility over the procurement contract. This creates a focal point from which other institutional relationships can be developed. Therefore, if the Government Procurement Center becomes the main office for contract management, then the individual agency benefitting from the goods and services being purchased simply becomes an advisor to the Center in making contract management decisions, as well as an agent of the Government Procurement Center in carrying out contract management decisions. Ultimate authority for contract management necessarily remains with the Center to lend certainty to the system and avoid conflicts among government agencies. However, if responsibility for contract management is to be given to the individual agency obtaining the goods and services, then a central office for contract management must be set up in each individual agency, and its relationship to the contract supplier, the Government Procurement Center (as immediate supervisory agency) and the Ministry of Finance and its departments (as ultimate supervisory agency) must be clearly established.

Finally, there is the tripartite relationship among the Government Procurement Center, the Agency obtaining the goods and services, and the non-governmental tendering and bidding company. Here the Government Procurement Center should be the ultimate authority. Although the intermediary tendering and bidding company is a non-governmental entity, it essentially carries out a public function and, therefore, must be treated as a mere agent of the Government Procurement Center in carrying out its functions. Conversely, the intermediary tendering and bidding company must understand that the Government Procurement Center, not the individual agency obtaining the goods and services, is in charge of the relevant purchasing activities. It should not be subject to inconsistent directives from two bosses, and should receive and fol-

low directions only from the Government Procurement Center. The individual agency need not be excluded from the process, but can secure a role in the process as advisor to the Government Procurement Center on the relevant purchase and by participating on the bid evaluation committee. This clear designation of roles helps to avoid risking bureaucratic confusion in carrying out procurement activities.

Similarly, the contractors submitting bids must also understand that the tendering and bidding company is the mere agent of the Government Procurement Center. The Government Procurement Center should bear ultimate legal responsibility for the handling of the tender and Bidding Process, vis-a-vis the contractor. The tendering and bidding company should be free of any legal liability to the contractors, with that responsibility belonging to the Government Procurement Center. Complaints lodged against the system with the Ministry of Finance and its departments, should be directed against the Government Procurement Center as respondent. The liability of the tendering agency, if any, is solely a matter between the Government Procurement Agency and the individual tendering company. Again, strictly delineating the role of each institution, and setting clear lines of communication between the contractor, the tendering company, the Government Procurement Center and the individual agency helps avoid the confusion derived from an overlap of functions and a lack of clearly defined roles.