

EIC Position Paper

on the Commission's Proposal for a

Regulation of the European Parliament and of the Council
on the access to Community External Assistance

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Introduction

European International Contractors (EIC) represents the interests of the European construction industry in all questions relating to its international construction activities. It has as its members construction industry trade associations from 15 European countries. The main objective is to improve the legal, economic and financial framework for European international contractors in the international construction business. As a matter of fact, Europe's international construction companies are currently active in all corners of the globe and are working in all types of infrastructure development procured under all kinds of procurement regimes. Throughout the last decade, the total volume of international turnover outside the Europe Union carried out by EIC member companies amounted on average to some 45 billion € annually. Regrettably, only a small fraction of this turnover was generated in connection with construction projects financed by the European Union.

Political Background

EIC considers its membership as partners in achieving the Millennium Development Goals and, therefore, generally supports all realistic initiatives that are apt to improve the efficiency of official development aid and development co-operation. We have noticed with great interest that the European Commission presented on 26 April 2004 a Proposal for a Regulation on the **Access to Community External Assistance** (*Document COM (2004) 313*), according to which future participation in the award of procurement or grant contracts financed under a Community instrument with a thematic scope shall be open to all interested parties of a developing or transition country, as defined by the OECD, in addition to those parties already eligible by virtue of the respective instrument.

We are also aware of the fact that the above-mentioned Proposal has to be seen in a broad political context and thus in conjunction with two recent Communications from the Commission, i.e. "**Towards the full integration of co-operation with ACP countries in the EU budget**" (*COM (2003) 590*) and on the "**Financial Perspectives 2007 – 2013**" (*COM (2004) 487*), which both aim at extracting the European Development Fund from its current regime and incorporating this significant important tool into the EU's general budget as of 2007. We understand that the two Communications and the above-mentioned Proposal taken together form part of the Commission's policy strategy to facilitate more coherence and consistency of external EU actions and to introduce a so-called "**Development Co-operation & Economic Co-operation**" Instrument which shall be Europe's main vehicle to support the developing countries in achieving the Millennium Development Goals.

We have also studied the Draft Report dated 08 March 2005 prepared by the **Committee on Development of the European Parliament** (*Provisional Document 2004/0099 (COD)*) on this issue. We second in particular some of the findings of the Committee, namely that:

- *“the instruments to be untied and the modalities for untying must be determined in function of their contribution to the attainment of the main goals of development assistance... [and] **If untying aid is not considered and regulated in this context, there is a risk that it may become counterproductive and hinder the attainment of the development objectives it intends to foster**”;*
- *concerning the donors (Article 3), “the opening of participation in the award of contracts to industrialised countries and countries in transition on the sole basis of economic and financial criteria, without any non-financial conditions attached to it, may generate detrimental consequences for the EU, as the result may be that contracts are adjudicated to countries that draw their competitive advantage from the **social dumping practice**. This would mean that the EU throws overboard... a number of **core values concerning development** (social, environmental and sustainable development)... The regulation should link the participation in an invitation to tender to the **bidder’s formal adherence to a set of minimal standards**... Companies based in or operating from countries that have not formally adhered to these international conventions should be excluded from participating in tenders”;*
- *Concerning the beneficiaries (Article 5), “... untying of aid should take place under the following conditions: **highest possible involvement of the beneficiary country**, taking into account in particular the need to **ensure the development of national and/or regional capacities**”.*

Queries with untying aid in the infrastructure sector

At the beginning of the 21st century, the world community still acknowledges an infrastructure gap to the effect that around 1 billion people lack adequate road access, some 1.1 billion lack a safe water supply, 2 billion do not have access to improved sanitation and 2.4 billion are estimated to lack electricity connection. The international development community meanwhile has realised that, on current trends, it is unlikely to meet most of the Millennium Development Goals by the year 2015. The “Global Monitoring Report 2004”, published in April 2004, has pointed out that infrastructure spending will need to rise by at least 3.5 – 5% of GDP in low-income countries and by 2.5 - 4% of GDP in low-middle-income countries in order to overcome the current infrastructure gap.

Against that background, EIC shares the concern of the international development community that all parties responsible for infrastructure development in world regions where infrastructure is desperately needed to achieve the Millennium Development Goals have an almost sacred obligation, towards both recipients and providers of such funds, to maximise the added value of every Euro or dollar spent in the realisation of such infrastructure.

EIC does not believe, however, that the simple fact of further untying official development aid flows will be sufficient to improve the donor’s performance or to enhance aid effectiveness, at least not in the infrastructure sector. Instead, a more comprehensive approach is needed.

Contrary to the OECD's Development Assistance Committee, we are not aware of any reliable international studies or estimates that would demonstrate that the elimination of tied aid assistance leads to better outcomes at lower costs. **By contrast, with regard to infrastructure projects it is highly doubtful, in our experience, whether the untying of aid alone will result in greater efficiency of the procurement of such works.** This is due to the fact that infrastructure projects – contrary to the purchase of goods - never come at a fixed price, but the costs of the works can increase in the course of the project, since they are influenced also by factors outside of the contractor's control.

Findings of the European Court of Auditors

Not surprisingly, the European Court of Auditors in 2003 came to the conclusion¹ in this context that in the case of infrastructure projects financed by the European Development Fund (EDF), the present European procurement practice must be improved. The Court of Auditors stressed, after looking thoroughly into the subject matter, that *“the European Union and the ACP states must improve supervision of the implementation of works contracts financed by the EDF and, in particular, must reduce the extent of the divergences that were found between contracts and their actual implementation”*.

EIC believes that the Commission's operative and organisational deficits, as identified by the Court of Auditors in the Special Report, would be aggravated by further untying official development aid for infrastructure projects at this stage, since the Commission would be faced with the irreconcilable task of organising greater competition at a time when customary procurement practices are considered to be inadequate. Circumstantial evidence of the currently existing problems may be that there **are still ongoing projects from the 6th, 7th and 8th EDF** and that there is a **remaining balance of 10 billion € from earlier EDFs**.

Comprehensive review of European official development aid

Against his background, EIC recommends that before the Commission in fact proceeds on further untying official development aid for infrastructure projects, it should improve beforehand the actual procurement procedures and practices to the extent that the tender process for infrastructure works allows the participating tenderers to make optimal use of their experience, technological and financial capabilities and creativity. In this context, it is important to keep in mind that in the case of large and/or complex infrastructure works, the costs involved in maintaining and operating the infrastructure facility over its lifetime always far exceed the initial costs of construction to the ratio of 1 for planning, 5 for construction and 200 for operation and maintenance on average!

In a nutshell: The topic of untying of aid must not be discussed in isolation but rather as an integral element of a comprehensive review aimed at modernising the present European procurement rules for official aid and official development aid. Given the current practice, as laid out by the Court of Auditors, the untying of aid alone will not result in systematic efficiency improvements. Instead, for sustainable development to be achieved, “Sustainable Procurement” is indispensable in both theory and practice.

¹ Special Report No. 8/2003 dated July 31, 200, see Official Journal of the EU 2003/C 181/01 (*cp.* http://www.eca.eu.int/audit_reports/special_reports/docs/2003/rs08_03en.pdf).

Key Issues in the Traditional Procurement

All over the globe, it is a complex endeavour to implement the design of and procurement for large-scale infrastructure projects. Even though the need for infrastructure facilities in developing countries is particularly acute, these countries by themselves are often not in a position to adequately design meaningful infrastructure projects that meet their development goals because of systemic weaknesses. Hence, they are dependent on the assistance of international donor institutions which should provide them with greater support already during this early project design phase. The following improvements should be made to the conventional design-bid-build procurement process:

- Firstly, as was stated by the European Court of Auditors in its opinion of 2003, weaknesses during the design phase always have a negative effect on the construction phase and result in changes of scope, type and length of projects.

EIC recommends that, on the one hand, a **sufficient budget** is made available by the Commission for both **preliminary studies and the design phase** and, on the other hand, **quality control monitoring systems should be introduced by the Commission** throughout the design phase.

- Secondly, high-quality planning also relies on the integration of **fair contract conditions into the standard bidding documents**. Only relevant international standard forms of contract should be used from which there may be no re-allocation of risk in the individual project.

EIC recommends that the Commission review its general contract conditions for development co-operation projects. **Harmonisation of these provisions with the contractual practices under Phare and ISPA would be helpful.**²

- Thirdly, if quality control were to be extended to the construction phase, **an efficient pre-qualification procedure** is indispensable. Such a process should obligate bidders to document not only their technical experience and financial strength, but, considering the social and environmental policy goals of the EU, bidders should also be required to show proof of their expertise in the field of environmental, labour and occupational safety standards.

In order to keep the costs for pre-qualification formalities within reasonable limits, EIC recommends to draft a **uniform pre-qualification procedure for all EU projects**.

Quality-Based Procurement

In the experience of EIC there is hard evidence that many employers in developing countries do not attach enough importance to the maintenance and operation of infrastructure projects, but focus too much on the construction phase only. Therefore, the Commission should increase the incentives for bidders to present solutions which optimise the balance between financial and technical considerations.

² For example, the Commission recommends using the FIDIC-sample construction contracts („New Red and Yellow Books“, 1999) for EU-financed construction projects under Phare and ISPA.

Whilst the European Commission's procurement rules for *Consultants* and *Services* explicitly prescribe the evaluation of the tenders in two separate stages – first the quality and then the cost – the general rule for the evaluation of the contractor tenders is, regrettably, the “lowest price” criterion. We reiterate, however, that the traditional tender system can hardly accommodate the quality aspect of the competition because when bidding under such a system, bidders have the option of either submitting an aggressive bid with a very low price and the wish to renegotiate any unreasonable risks incurred later, or to submit a reasonable bid which duly prices all the risks contained in the tender documentation. Usually, if one of the bidders uses an aggressive approach seeking re-negotiation later, a reasonably priced bid may not appear to be competitive. This leaves the reasonable bidder with a disadvantage and the more aggressive bidder with an opportunity to renegotiate in search of a deal that works. Such practice in turn leads usually to the observations made by the European Court of Auditors with respect to EDF-financed infrastructure projects.

There are – better - examples of procurement practice in Europe, where Contracting Authorities in case of large-scale infrastructure projects invite tenders on the basis of various criteria other than price (e.g. quality, performance specifications, design requirements, time for completion, life-cycle costs, etc.). Of course, the interpretation of public procurement rules should respect also under these systems its primary objective, which is economical in nature. However, **quality-based tender mechanisms can integrate life-cycle and environmental criteria** without replacing the primary objectives of procurement. It should be recalled also that the European Court of Justice has recently decided that the “lowest price” is recognised as being an “objective criteria”, but that the selection of a single award criterion deprives the Contracting Authority of the ability to take into account the nature and specific features of each contract, to choose the most appropriate criteria for free competition and therefore to make sure that the best tender is selected. The Court concluded that a framework law on public works procurement, which for both the open and the restricted procedures imposes the sole “lowest price” as mandatory award criteria, runs counter to Community law.³

Performance-Based Procurement

As a way of broadening the awareness of both financiers and employers for the benefits of a quality or even life-cycle approach towards construction, EIC would like to suggest to the European Commission to expand its procurement canon, at least for complex infrastructure projects, by functional or user-oriented procurement procedures, thus prescribing competitive bidding over the entire value-added chain (design – construction – operation and financing, if applicable).⁴ In this connection, EIC fully backs a recent **World Bank research study on Performance-Based Procurement (PBP) of donor-funded large, complex projects** which has recently investigated whether the procurement of large, complex projects should, in some cases, be made on the basis of performance or functional specifications. The study, which is limited to infrastructure type projects, particularly in the fields of power production, water and sewage, and the other utilities, concluded that there are “*a number of very significant benefits to be gained by all concerned when PBP of projects of the types mentioned are adopted*”.

³ ECJ Case C-247/02, “*Sintesi SpA vs. Autorità per la Vigilanza sui Lavori Pubblici*”

⁴ Compare the so-called “Legislative Package”, Directive No. 2004/18/EC, published in the Official Journal L 134, 30 April 2004.

The main conclusions of the study can be briefly summarised as follows:

- Contractors and manufacturers may offer their own newer, more efficient and often cheaper technological solutions;
- Research and development by plant manufacturers and suppliers will be stimulated to the benefit of all concerned;
- Nothing in the World Bank's Procurement Guidelines or Standard Bidding Documents precludes the use of performance or functional specifications;
- Pre-qualification followed by a two-stage procurement procedure is most suitable;
- European experience shows that PBP has worked well where Employers with qualified and experienced staff have taken over and operated the completed facilities themselves;
- In developing and transition countries, when Employers do not have suitably trained operation and maintenance staff, more satisfactory results may be achieved by requiring the contractor to be responsible for the operation of the completed facility, i.e. for providing a service to the users rather than just a facility;
- Preparation of functional specifications and evaluation of tenders requires consulting engineers with competent and experienced technical draftsmen.

Conclusion

The measures proposed in this Position Paper by EIC, such as a better preparation of the project, the optimisation of the distribution of contractual risks, the pre-selection of qualified bidders, the calculation based on a life-cycle concept, the shifting of the planning and the operation of projects to the private sector, could, in our view, all make an effective contribution to achieving important development policy goals, among them, e. g., a **realistic portrayal of "hidden" environmental and social costs** (cost transparency), **elimination of abnormally low bids**, **modernisation of the local administrative system** and, last but not least, **elimination of corruption**. In this way, a modern procurement system also contributes directly to **"Good Governance"**.

While, in principle, the untying of aid may be a tool to increase efficiency, its practical application can have counterproductive effects, if not supported by an efficient procurement system which is capable to strike a balance between time for completion, quality and price. EIC hereby calls on the European policy-makers to integrate into the further political debate on the untying of aid a comprehensive discussion on how to modernise Europe's respective procurement regime.⁵

EIC would welcome an institutionalised dialogue on this topic between all interested parties and would, of course, be pleased to participate in such an exchange of opinion and experience.

⁵ A detailed presentation of the elements that should be included in a comprehensive approach to improve procurement procedures and conditions is contained in the „EIC Blue Book on Sustainable Procurement“, published by European International Contractors, Berlin 2004 or from our website under (CP. http://www.eicontractors.de/doc/tc/eic_document_tc_0016.pdf).