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PUBLIC PROCUREMENT

REGIONAL AND SOCIAL ASPECTS

(Communication from the Commission)

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1. INTRODUCTION - THE PROBLEM

1. The liberalisation of public procurement is part of the programme for the progressive establishment of the internal market in the period up to 31 December 1992, provided for under Article 8(A) of the EEC Treaty.
2. Article 8(C) EEC provides that the Commission, in making its proposals, shall take into account the extent of the effort which the establishment of the internal market will require of economies showing differences in development, and that it may propose appropriate provisions.
3. Article 130(A) and (B) EEC further lay down that the internal market shall take into account the strengthening of economic and social cohesion and shall contribute to their achievement.
4. This makes clear the obligation for the Commission to consider, both for the period during the establishment of the internal market and for the period after its completion, measures which would reinforce the Community's economic and social cohesion.
5. The concern with implementing the internal market in public procurement in a way that takes fully into account the needs of economic and social cohesion has been a consistent concern of the European Parliament. In its consideration of the different proposals which form the legislative programme on public procurement, the Parliament has adopted a series of amendments with this end in view. In particular, the Parliament has been concerned about measures intended to reduce regional disparities and to promote job creation in the least advantaged areas and in areas of industrial decline. However, its concerns have ranged wider, including actions to help in the fight against long-term unemployment and in the insertion of young people in work; the respect for the appropriate provisions concerned with employment protection and working conditions; and sub-contracting, in the execution of public contracts.
6. The problem of regional preferences has also been discussed in Council on several occasions in connection with the modernisation of the supplies and works directives. A number of Member States have insisted on the need to ensure that preferences do not interfere with the proper functioning of the internal market.
7. The present Communication represents the Commission's response to the requirements of the Treaty and the concerns expressed by the European Parliament and Council.

11. ECONOMIC EFFECTS OF OPENING-UP PUBLIC PROCUREMENT

8. The economic importance of public procurement derives in the first place from its scale. Some 15 % (592 billion ECU at 1989 prices) (1) of Community GDP is devoted to purchasing by the public sector and its agencies and of this some 7-10 %⁽¹⁾ (260-380 billion ECU) takes the form of contracts subject to formal purchasing procedures (the rest is accounted for by rents, heating, electricity, telephone, post, insurance and similar charges).
9. It is evident that the achievement of efficiency in public procurement is of major importance to the economic health of the Community.
10. This requires both the fullest possible participation of all potential suppliers in the market place and the allocation of contracts in a way which ensures that the goods, services and works required by bodies in the public domain are obtained under the most favourable conditions.
11. Public procurement policy as expressed in the Directives on the procurement of supplies and public works and in the proposal for directives on the excluded sectors aims to enhance the efficiency of public procurement by organising markets in a transparent manner that ensures that market information is available to would-be suppliers and contractors and facilitates their participation.
12. The efficient organisation of public procurement in this way will have a significant positive economic effect. The estimates developed in the study of the Cost of Non-Europe show that the achievement of the internal market in public procurement will give rise to economies rising to as much as 0.5 % of Community GDP over the medium to long term.

These estimates assume :

	<u>Billion ECU</u> (1989 prices)
(a) Savings to public procurement through selection of most competitive suppliers	5.5
(b) Savings due to increased competition leading to alignment of domestic and external suppliers	2.8
(c) Savings due to rationalization of production structures	8.9
	<hr/>
	17.2 ⁽²⁾

(1) See European Economy : No 35 March 1988 para 54, para 3.4 and Tables 3.4.1 and 3.4.2 : 1989 values assume no change in the ratio of public procurement to GDP as between 1985 and 1989 : 1989 prices estimated on basis of implied deflators of private consumption given in Table 6 : EEC Economic Forecasts, January 1989

(2) op. cit. p. 57 : Table 3.4.4 with 1989 prices estimated on the same basis.

Additional savings in the defence sector would bring the total to over 22 billion ECU, at 1989 prices. The macro-economic consequences of such savings could, of themselves, provide the room for manoeuvre for a substantial enhancement to aggregate demand with consequential reinforcement of economic activity and employment. The Cost of Non-European study estimates the net gain in employment to approach 400,000⁽³⁾ if this room for manoeuvre is used appropriately.

13. At the same time it is clear that the direction of such a major share of economic resources constitutes a powerful economic instrument. The allocation of public sector contracts can have an important, indeed determinant, influence on the economic strength and development of particular firms, sectors and regions.
14. The importance of this instrument is further enhanced by the uneven distribution of public procurement across different economic sectors. As was explained in a previous Communication⁽⁴⁾, some 85 % of public procurement of supplies is concentrated on one third of the industrial sectors, including 28.6 % in building and construction, 13.7 % in the three major energy sectors (coal, refined petroleum products, electrical power), 8.3 % in transport equipment other than motor vehicles, 4.4 % in electrical goods, 3.2 % in chemical goods.
15. Many high technology markets including telecommunication and medical equipment depend heavily on public procurement. In information technology, generally, the public share amounts to some 60 % of the total market. The share of public procurement in building and civil engineering is around 30 %. The involvement of major equipment suppliers, particularly in the supply of the telecommunications, transport, energy and water sectors, means that the choice of one supplier rather than another, the rationalisation of a sector, dramatic changes in technology or swings in the overall volume of demand for supplies can have a major impact on a regional or local economy and on the situation of its workforce.
16. It is implicit in the programme for the establishment of the single market in public procurement that removal of internal barriers will give rise to changes in the distribution of contracts and therefore to more efficient procurement. The overall benefits of this process have been described above. It is inevitable that such changes will imply rationalisation; this is indeed the source of much of the saving referred to above. Although the studies already undertaken by the Commission show some of the scope for such rationalisation, its regional, industrial and social consequences are not predictable⁽⁴⁾ in detail at this stage and are, in any case, tied up with other major economic developments, with the interpenetration of other Community measures, such as freedom of establishment and common technical rules and with developments in public procurement itself, for example, in the field of sub-contracting.

(3) op. cit. (v. footnote p. 160)

(4) COM(88) 376

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17. In other words, while the overall consequences for economic demand and employment will be positive, the distribution of the pain and the gain between firms, groups and regions will only become apparent with time.
18. The Commission is, however, committed to continuing the study of the regional effects of opening up public procurement in the excluded sectors (see para 25).
19. It has also initiated a more general study on the threats and opportunities posed by the Internal Market in the peripheral Member States. Results so far suggest that negative regional effects of opening-up public procurement are only likely to be significant in sectors such as construction, pharmaceuticals and textiles. Increased competition may not necessarily threaten domestic markets. There may, however, be a risk that the opportunities created by the opening-up of public procurement will not be seized, because of the historic legacy of protection, technological backwardness, low productivity, failure to organise markets, and poor exporting skills.
20. In summary, the completion of the internal market in public procurement affects economic and social cohesion by :
 - increasing efficiency, and so reducing the burden on the public purse and enhancing macro-economic growth;
 - promoting re-structuring and adjustment;
 - creating the opportunity for firms, sectors and regions to exploit their particular skills and advantages to their economic benefit;
 - influencing the direction in which many firms, sectors and regions develop, which may pose problems for economically weaker areas.
21. The economic and social effects of public procurement described above give rise to three distinct areas of policy development. These concern :
 - policies for efficient procurement. These are the subject of the various proposals relating to public procurement which are to be found in the Internal Market White Paper⁽⁵⁾. They are not further discussed here;
 - policies to facilitate restructuring and adjustment arising from the liberalisation of public procurement and its subsequent development; these are briefly discussed in paragraphs 22-25 below;
 - policies to ensure the full exploitation and development of particular resources, particularly relating to regions, small businesses and particular groups of individuals. These are discussed under 4 headings in chapter IV below.

(5) COM(85) 310

III. RESTRUCTURING AND ADJUSTMENT ARISING FROM LIBERALISATION OF PUBLIC PROCUREMENT

22. Restructuring and adjustment is inevitable as a result of the achievement of the internal market in public procurement. Indeed, as was pointed out in the earlier Communication referred to above, restructuring and adjustment of a number of major sectors appears to be inevitable quite independently of the changes in public procurement associated with the achievement of the internal market. The Communication of 11 October 1988 predicted significant structural adjustment in the railway equipment industry, the heavy electrical industry and the telecommunications industry. Since then, important regrouping within each of these industries has indeed taken place.
23. The earlier Communication also pointed out that, while some information was available as to the existing regional distribution of employment in the sectors concerned, it was impossible to predict, at this stage, the detailed impact of restructuring. This would depend, quite apart from the development of the general economic situation, on the speed and success with which individual firms moved to exploit new opportunities or to face new competitive pressures. Even if some of the firms at risk could be identified, the distribution of their productive plant means that the regional incidence of restructuring will depend on investment, development and rationalisation plans adopted within those firms. For example, some 11 major production sites were identified for fossil boiler production, 9 for steam turbine generators and 17 for transformers. The regional consequences of restructuring of the industries concerned will clearly depend on which, if any, of these sites expand or contract their employment.
24. To describe the difficulties in predicting problems is neither to deny that such problems may arise nor to resolve them. Even if the liberalisation of public procurement produces an overall improvement in activity and employment and if the measures taken under the structural funds or as described elsewhere in this Communication ensure full participation of the regions in these benefits, there will be a need for constant vigilance to ensure that the real readjustment problems, which are, in the end, experienced by individuals, are resolved satisfactorily.
25. The Commission has established a continuing study to identify as early as possible any emerging problems. If particular problems do emerge, appropriate social and regional policy measures may then be taken by the Community under the Structural Funds, and through recourse to the European Investment Bank and to other financial instruments.

IV. FULLER EXPLOITATION AND DEVELOPMENT OF ECONOMIC RESOURCES

26. Regional enterprises and small businesses may not have the access to opportunities for specialization, to capital and to know-how which often reinforce the position of the centrally located areas of greatest economic advantage. Low wages in the peripheral areas do not necessarily compensate for higher productivity, better infrastructure serving industry and a more sophisticated approach to marketing and product development. With the completion of the internal market, regional enterprises are further being challenged to reach the average

European performance level at a time when European standards of quality and efficiency in traditional labour-intensive industries are evolving rapidly.

27. Ignoring their vulnerability not only risks exposing regional enterprises to competition for which they are ill-prepared, organisationally, financially and technically. It also risks blocking the process of completing the internal market by encouraging apprehensive and defensive attitudes. Subsequent sections of this chapter examine ways in which the Community could respond to the specific challenges posed in the fields of employment, SME and regional policy.

IV.1 Preference schemes in public procurement

28. Preference schemes in public procurement are operated by certain Member States in favour of less-favoured regions, with the object of influencing the spatial distribution of economic activities. They constitute an addition to the classic instruments of regional development and generally aim at compensating for the handicaps faced by firms due to their location in the less-favoured and peripheral regions. In the case of the Federal Republic of Germany, the aim is to compensate for the economic disadvantages caused by the economic division of Germany. As a way of compensating for these handicaps, preference schemes in public procurement are policies which discriminate, by reserving markets or in terms of price or other conditions, in favour of suppliers or contractors of poor regions.
29. In general, it may be said that preferences in the area of supplies procurement have tended to be used to favour longer term regional development aims whereas, in the area of public works procurement, much more importance has been attached to the use of work contracts to provide an immediate response to employment problems.
30. The adoption of the directives on public procurement of works (1971) and supplies (1976) led to the abolition of a number of such schemes and practices. Regional preferences have continued to operate in the Federal Republic of Germany, Greece, Italy and the United Kingdom. An outline of these schemes is given in Annex I.
31. Such schemes raise a number of questions including their effectiveness as instruments of regional policy; their compatibility with the economic objectives of Community policy on public procurement; and not least their compatibility with Community law and the Community's international obligations.
32. As regards their effectiveness as instruments of regional policy, the following observations may be made on the economic characteristics of the different schemes.
33. The preference scheme in favour of the eastern frontier areas of Germany including Berlin appears to have been of limited economic significance in recent years. In 1986, the last year for which figures

are available, the regions in question contained approximately 15 % of the population and enterprises located therein accounted for approximately 15.4 % of federal public procurement. The value of the contracts to which the preferences were in fact applied amounted to slightly more than 142 million ECU, that is 0.25 % of total federal public procurement. The cost to the federal budget was approximately 2 million ECU, that is, less than 1 % of the total expenditure on aid to the regions in question.

34. Although the preference scheme operated in the United Kingdom applied to 18 % of the country by population share, in 1981, the last year for which figures are available, enterprises located in those regions accounted for only 3.3 % of central government procurement. The preferences were actually applied to contracts representing only 0.02 % of total public procurement, the value of those contracts amounting to 10.8 million ECU. The cost to the public purse can be estimated to have been in the region of 17,000 ECUs. This very low figure refers to the cost of the 5.0 % price preference regime in Northern Ireland, the other scheme requiring preferred firms to be price competitive with the lowest bidder.
35. In neither the British nor the German case is there reliable evidence of the preference schemes having made a significant contribution to the development of the regions concerned. At the same time, there is no evidence either of them giving rise to significant distortions to trade whether within those countries or between them and other Member States.
36. The Greek regime applies to over 90 % of the national territory in which regions live 65 % of the population. Detailed information on the preferred regions' share of public procurement, the proportion and value of public contracts to which preferences are actually applied and the budgetary cost of the regime have not been made available to the Commission. However, it is reported that due to the absence of competitive suppliers in any Greek region, approximately 40 % to 45 % of public procurement is represented by imports, a figure which is far above the Community average.
37. The aim of the scheme operated in Greece is to avoid too great a concentration of economic activities in Greater Athens, already a zone of high congestion, and to favour the development of other regions. However, while this scheme and other regional policy measures may have had some positive effects, they have not been sufficient to reverse the trend towards the concentration of modern, industrial sectors in Attica, with traditional activities located in the regions and islands.
38. In Italy, the schemes work by reserving a high percentage of contracts to firms in the regions concerned. Those regions contain approximately 40 % of the Italian population. Under the national regime, there is a basic reservation of 30 % of procurement which rises to 50 % in the case of supplies for public works financed by special intervention funds. Moreover, the reservation can be even greater because when in a

given case it is not fully applied, the unused portion must be added to the future reserved allocation of the purchasing body. No public figures are available, but a recent submission to the Commission has estimated the amount of public procurement to which the reservations apply to be in the region of 16 to 26 billion ECU a year.

39. No compelling evidence exists as to whether the Italian preference regime has contributed significantly to the long-term economic development of the regions in question. In recent years, however, the regime has given rise to objections from firms situated in other parts of Italy and other Member States on the ground that it is an unacceptable restriction on their activities in those regions.
40. Historically, it may be argued that preferences may have contributed to a more balanced functioning of the economy, by helping to limit the widening of regional disparities through guaranteeing certain markets. They may also, in certain cases, have served more than a positive function, in providing the minimum of financial security necessary to the development of new technically innovative industries. There is no compelling evidence that, in general, the existing schemes have had the desired effects of long-term economic development. The absence of evidence, one way or the other, concerning the effect of these schemes is no doubt due in large part to the difficulty of analysing the effects of one policy instrument when so many other factors are present which influence the long-term economic development of the regions in question. In the case of the German and British schemes their effects in general appear to be rather limited. The absence of sufficient data on the Greek regime make its impact hard to assess. On the other hand, the Italian regimes are significantly different both in their mechanisms and orders of magnitude. There is little doubt that contracts have been diverted to enterprises of the regions concerned to the point where the resulting distortions are causing problems not only in terms of the restrictive effects on imports from other Member States but also as regards the sales and development of firms in other Italian regions.
41. Indeed, in so far as the existing regional preference schemes privilege enterprises from particular regions to the exclusion of all others, they all pose problems from the point of view of their compatibility with the fundamental aims of Community procurement policy and indeed the Treaty itself. They do not operate in a way which ensures that similarly situated enterprises are treated equally. They may have as their effect directly to deprive particular suppliers, situated outside a given region, including those in regions at a similar level of economic disadvantage, of the award of a contract to the benefit of others, situated within that region. Even if they are not very successful at doing so, this appears to constitute an infringement of the EEC Treaty, notably its paragraphs Articles 30 and 59. Article 92 EEC, notably its paragraphs 2(c) and 3(a), might appear to provide a framework within which schemes which operate as State aids could be accommodated. However, even if some schemes could be considered to be State aids within the meaning of the Treaty, which is itself an arguable matter, this does not resolve the overriding problem of the infringement of Article 30 and 59 for which a solution would remain to be found.

42. The Court of Justice has been requested by several Italian courts to give preliminary rulings concerning the compatibility with Community law of the preference system operated in Italy. The Commission in its written intervention has taken the view that the Italian system is incompatible with Article 30 EEC. The Court has not yet delivered its ruling. The condemnation of the Italian regime would of course have implications for the regimes of the other Member States, exposing such regimes to legal attack at national level.

IV.2 Non-discriminatory contract conditions

43. A further possible means of favouring the full exploitation of available economic resources arises from the use of non-discriminatory contract conditions.

44. In a recent case (31/87, Gebroeders Beentjes B.V. and the Netherlands) the Court of Justice was requested to rule on the compatibility with Community law of attaching a condition to the award of a public works contract under which the contractor was required to engage a given number of long-term unemployed registered with a regional employment office. The Court held that such a condition is compatible with the public works Directive (71/305). It was nevertheless subject to the Treaty, particularly those provisions on freedom to provide services, freedom of establishment and non-discrimination on grounds of nationality. The Court referred the affair back to the national tribunal to establish whether or not the particular clause was, in the light of all the circumstances, compatible with the Treaty.

45. This judgement raises a number of interesting questions :

- could such conditions be legitimately be applied to objectives other than the reduction of long-term unemployment; and if so, to what ?
- within what limits can such conditions be applied ?
- does the use of such conditions offer a useful policy instrument ?

a) Legitimate objectives of contract conditions

46. Although the Beentjes case concerned long-term unemployment, there is no reason to suppose that objectives other than the reduction of long-term unemployment would fall outside the area of liberty left to the Member States by Directive 71/305. Other categories of unemployment, for example, of the young, would appear to be an equally legitimate concern. The same probably applies to a broad range of social matters including, for example, professional training, health and safety, labour relations and the suppression of racial, religious discrimination or discrimination on the grounds of sex. In these areas too, the procurement directives neither forbid nor expressly authorise Member States to regulate the matter. Accordingly, they and procuring entities are free under Community law to pursue such objectives, provided they respect the directives' provisions and the constraints of the Treaty. It also follows that Member States are free under Community law to restrict the capacity of procuring entities to pursue objectives of this kind.

b) Limits to the application of contract conditions

47. The Court drew a distinction between the contractual condition concerning long-term unemployment on the one hand and the criteria for selection of firms and the criteria for the award of a contract on the other. The condition was not relevant to an assessment of the bidders' economic, financial or technical capacity to carry out the work. Nor did it form part of the criteria applied by the purchasing authority to decide to whom to award the contract. It was simply an obligation which the firm securing the contract would have to accept.
48. However, in some cases, conditions of the contract will concern matters also relevant to the selection criteria or to the award criteria. For example, making the extent to which tenderers would employ the long-term unemployed into one of the criteria for identifying the most economically advantageous tender, even if the obligation to employ the number of long-term unemployed indicated in his offer was expressed as a contract condition, would raise difficulties with Article 29 of the Directive on public works. The "various criteria" given as examples in that Directive all relate to matters which affect the economic benefit to the contracting entity of the offer in question in the context of the subject matter of a particular works contract. A tenderer's capacity to employ the long-term unemployed does not normally have any impact on the economic benefit of the contract to the procuring entity. Economic benefits which may result, for example, through the reduction of welfare payments or an increase in spending by those employed, are indirect and quite extraneous to the subject matter of the contract itself. Unless particular circumstances could be shown to exist under which employment of the long term unemployed would improve the economic benefits of the contract to the procuring entity, this criterion would not be compatible with the Directive. The same applies to other criteria which have nothing to do with the subject matter of a particular contract.
49. Further, the Court stressed that contract conditions must in any event respect relevant provisions of Community law. It referred in particular to restrictions flowing from the Treaty principles of right of establishment and freedom to provide services and to the principle of non-discrimination on grounds of nationality. In this context, it considered that the contract condition could breach the non-discrimination principle if it appeared that it could only be fulfilled by national firms or if it would be more difficult to fulfil for bidders coming from other Member States.
50. Much will therefore depend on the precise condition imposed and its practical effects on bidders from other Member States. Some examples may serve to clarify the problem.
51. A simple condition requiring the winning tenderer to employ a given number or percentage of unemployed or long term unemployed or young unemployed for the execution of the works contract would not seem to discriminate against bidders from other Member States. All bidders, national and other, will have to take on persons presently unemployed and all have similar opportunities (and difficulties) to do so.

52. But a requirement that the winning tenderer employ a given percentage of persons resident in the area in question would, on the face of it, be discriminatory. Local firms will in all probability already employ local residents and, in any case, will be familiar with the local labour market. Firms from outside the locality and a *fortiori* from other Member States will be much less likely to employ residents and will have to prospect the local labour market from scratch. They clearly risk being disadvantaged.
53. In between these extremes lie cases which would require careful evaluation. For example, a requirement for the winning tenderer to recruit a given number or percentage of long term unemployed registered with the local employment office, the kind of clause that gave rise to the Beentjes case, would raise the question as to whether it is easier for the local firm to do so than an outsider. A commitment by the local authorities to make available a supply of the appropriate labour, for example through an employment agency, might give some guarantee that it is not. Where action is taken in accordance with the plans referred to in the structural funds regulations or in the context of a project financed by an aid notified to the Commission, the fact that the plan was considered or the aid examined at Community level without objection would imply that the Commission considered it non-discriminatory, unless some particular factor arose to show the contrary which was not apparent earlier.
54. A further dimension of the problem needs to be considered. The Court limited itself in Beentjes to the suggestion that the condition might discriminate against outside contractors. However, discrimination might also arise against other Community workers. Cases will have to be evaluated from this point of view also.
55. Thus it is apparent that the compatibility of contract conditions with Community law requires, on the basis of present legislation, a case by case analysis. This applies not only to conditions addressing unemployment, but to other fields that could be imagined.
56. In the field of training, for example, a condition that firms employ a given number or proportion of trainees exclusively from national training programmes would appear to discriminate against trainees in equivalent schemes in other Member States. It would accordingly not be admissible. On the other hand, an obligation to employ trainees which does not limit their provenance on national lines would not appear to pose a problem.
57. In the area of equal opportunities, an obligation to employ a given number or proportion of women or persons from some other category not based on nationality would also not appear to give rise to difficulty, though of course a definitive judgement necessarily depends on an appreciation of all the material facts of a particular case.
58. The same applies to clauses designed to ensure that firms respect prevalent terms and conditions of employment when working in a

particular locality. All firms whether local, national or from another State are treated equally. Neither foreign firms nor foreign workers are disadvantaged by comparison with nationals of the Member State in question. However, a condition that all persons employed in execution of the contract benefit from the local terms and conditions would pose problems if it were intended to apply also to persons in other Member States. Even in the works context, some employees who work on the contract may be employed outside the territory of the State of the contracting authority. In the supplies context, this situation is of course much more common. It is difficult to see what justification there could be for admitting requirements which would permit national contracting authorities to export local terms and conditions of employment to other Member States. Such requirements could provoke intolerable conflicts of law and policy and also eliminate important elements of the competitive advantage of firms in States with lower labour costs, in particular, less developed regions. The Court did not address this issue in the Beentjes judgement and great care should be taken in drawing any inferences about it from that source.

59. In summary, the doctrine of the Court in the Beentjes case leaves the application of contract conditions limited in three ways :

- the contract condition should be independent of the assessment of the bidders capacity to carry out the work or of award criteria;
- it should not infringe other principles of Community law, particularly that of right of establishment, freedom to provide services and non-discrimination on the grounds of nationality. In practice this appears to require a case by case examination;
- it only authorises conditions which seek to realize objectives on the territory of the State of the contracting authority.

c) Do such conditions offer a useful policy instrument ?

60. The usefulness of the possibilities offered by the judgement in the Beentjes case as a policy instrument is limited in three ways.

61. In the first place, the scope for the use of conditions is much more limited in the area of supplies than in the area of public works. Given that supplies contracts are largely executed in the factory, it is hard to imagine how conditions of a social nature could be applied in the award of a supplies contract without either discriminating between domestic and other suppliers or seeking to achieve objectives outside the territory of the State of the contracting authority. It is in the case of works contracts, where the work is for the most part carried out on the territory of the State of the contracting authority, that the possibility of satisfying the Court's requirements is most likely to be met.

62. In the second place, the usefulness of the instrument is in practice limited by the primary objective of the contract itself. A

contracting authority which plans the construction of a building or a bridge is likely, in most cases, to want the construction to be carried out under the circumstances which give rise to the best and most efficient construction giving best value for money. This limits the extent to which other goals may be pursued which may adversely affect the contract's primary objective.

63. In the third place, the need for a case-by-case examination of the compatibility of particular conditions with the circumstances of individual contracts limits the confidence with which particular conditions can be imposed. The risk that a condition will be contested by a participant in an award procedure, leading to delays and additional costs, with a possible reduction in efficiency as well, makes the use of the instrument uncertain as to its results. While the uncertainty may diminish as experience is gained in using this type of clause, it inevitably calls for a cautious approach at present.
64. However, despite these limitations, contract conditions do appear to offer a policy instrument which, in circumstances where there is a ready supply of labour, such as long-term unemployed or unemployed young people, can be used to help in the insertion of unemployed people in work. In view of the difficulties inherent in establishing non-discriminatory conditions, additional security as to the legitimacy of such schemes could be obtained by discussing them with the Commission in advance. They could also be used for other ends, where not forbidden by national law, such as ensuring that work carried out on a particular site respects certain working conditions, for example, those generally prevailing in the area in question.

IV.3 Promoting the participation of SMEs in public procurement

65. Promoting the participation of SMEs in public procurement is an important factor in economic and social cohesion, both at national and Community level. Small and medium-sized firms are often less well informed of the opportunities offered in this field, or hesitate to venture to negotiate transnational contracts with administrations, with which they are not acquainted (problems of language, contract terms, movement, delays in payment, legal remedies in case of dispute). SME participation in public procurement has, in any case, been relatively low in the Community, compared with the United States, Canada and Japan. The Commission is assessing in depth all the aspects of the problem, in the light of a recent study⁽⁷⁾. A more detailed and comprehensive communication to the Council will be prepared on SME participation in Public Procurement and also a draft Commission recommendation to the Member States on certain aspects of this problem (see paragraphs 99 and 100 below).
66. At the national level, the problem is perhaps less sensitive, but it is real. That is why, for several years, in the majority of industrialized countries, contracting authorities have implemented measures to increase the share of SMEs in public procurement.

(7) 'SMEs and Public Procurement', prepared by WS Atkins for the Commission 1988.

67. In addition, the Community has already implemented measures to stimulate the participation of SMEs in public procurement on a Community scale. Their coverage could be developed later. These measures are analysed through the six facets presented below.

a) Better Information of SMEs concerning public procurement markets

68. The Community provides means whereby contracting authorities and the SMEs themselves can obtain information about public procurement; in particular, the network of Euro-Info-Centres, linked to the TED data base, ensures the circulation of contract notices and assists SMEs in responding to those which are of interest to them. There is provision, within the scope of the amended directives on public procurement, for the publication of information on purchasing programmes for supplies ("pre-information" procedure) and also of information concerning the award of contracts.

69. These actions in the information field could be further developed by complementing the provisions in the directives with other measures of a non-obligatory character. These could include :

- the development of data banks permitting those contracting authorities that wish to do so to publish, efficiently and at low cost, contracts below the thresholds in the directives and so make them available to SMEs throughout the Community;
- the incorporation in such data banks of information on potential SME suppliers indicating their field of activity, their previous experience in supplying the public sector, and other information relating to quality assurance;
- the organisation of public procurement fairs designed to bring SMEs into new relationships with the contracting authorities of other Member States. Useful information could be made available to SMEs through the TED data base.

b) Training of managers of firms

70. The training of managers of firms is an essential dimension in the integration of SMEs in the Single Market. This is why the Commission has recently adopted a programme "Preparing the SMEs for the Europe of 1992" through which it will support relevant training projects. The better the training of managers of small and medium-sized enterprises, the more these enterprises will be disposed to develop their business, the field of public procurement included, on a Community scale.

c) Improved access to larger contracts : division of larger contracts into lots

71. The break up of larger contracts carries the risks of adding to administrative costs and offering a pretext for evasion of the thresholds of application of the public procurement directives. It is

not therefore attractive, if the only objective is to encourage the participation of SMEs. This does not, however, apply to the division of a larger contract into lots. The contracts for the lots would still be subject to the directives, including their publication provisions. This would allow smaller firms, which could not bid for the whole, to try for a part of the work.

72. The objection may be made that such approaches may be inconsistent with the search for economies of scale. This objection seems to be without foundation, as long as bids may be made for all the lots. In these circumstances, an SME bidding for one lot will have to make an offer as economically attractive as another enterprise bidding for the whole and exploiting the economies of scale. The SME's chances of winning the lot will then depend on it having a compensating competitive advantage, for example, greater flexibility or lower overheads.
73. Division of larger contracts into lots is compatible with the directives. However, it should be possible to make this clearer either in the texts of the directives themselves or, if that must await a more convenient time in the future, in a Council resolution or recommendation which would in effect be a formal interpretation of how the directives may be applied in this area.

d) An active sub-contracting policy

74. Sub-contracting also plays an important role in improving the access of SMEs to larger contracts. It is perceived in most Member States as an effective means of encouraging greater competitiveness and greater efficiency and fairness in public procurement. The Community might seek to develop the use of sub-contracting to favour SMEs in the following ways :
- clarify the extent to which the directives already provide scope for sub-contracting to be used for this purpose;
 - facilitate the development of new relationships between prime contractors and sub-contractors by making more information available, particularly as regards the indication by the tenderer, when he submits his tender, of his intention to sub-contract, and through the publication of such information when notice is given of the award of a contract;
 - treating SMEs on a basis of equality with prime contractors, particularly from a legal, technical and financial point of view;
 - clarifying the legal status of sub-contractors as regards their rights and obligations.
75. Nothing, however, should be done which permits abuse of sub-contracting to the detriment of respect for the obligations of prime contractors and sub-contractors. Particular attention should therefore be paid to abuses in the fields of tax and social security, to ensuring that prime contractors are in a position to pay sub-contractors on time. In certain cases, contracting authorities should be prepared, perhaps, to ensure direct payment themselves.

76. Steps should also be taken to see that prime contracting authorities fulfill their responsibility to give sub-contractors no less favourable terms than they receive from contracting authorities and possibly assist them in meeting quality requirements.
77. The availability of effective remedies for sub-contractors in case of unjustifiable non-payment or failure of the prime contractor or possibly other unfair practices such as unreasonable certification requirements could also serve to strengthen the security of SMEs.
78. Finally, standard contractual provisions on sub-contracting might be developed, with the object of producing broadly similar legal results in all Member States. This would allow SMEs to seek sub-contracts in other countries with greater confidence. Prime contractors would also have the advantage of increased confidence that a sub-contractor from another Member State was aware of the main legal provisions determining his rights and responsibilities.

e) Mutual guarantees of fair and effective performance

79. An important constraint on SME participation public contracts is the lack of confidence on both sides that the relationship will lead to an outcome that is effective and fair. Measures have been taken in some national contexts to address this problem by reducing difficulties relating to :
 - availability of financial guarantees to ensure that SMEs do not withdraw offers once made and perform contracts to time and specification;
 - improvement in the conditions for granting such guarantees;
 - the creation of mutual insurance systems to guarantee the solvency of enterprises, as well as the good execution of contracts;
 - ensuring efficient and fair payment systems.

e) Association of enterprises

80. Cooperation between SMEs can help to compensate for their weaknesses. For example, contracting authorities could assess the capacity of a joint venture to undertake a contract on the basis of the combined financial and technical capacity of the association as such. Such cooperation between SMEs in various Member States could take place within the legal framework of the European Economic Interest Grouping (E.E.I.G.) from July 1989 onwards.

IV.4 Greater regional participation in Community public procurement

81. Opening up the public procurement market poses specific challenges to the enterprises of the less-favoured regions. These include historic dependence on regional preferences or other forms of protection, the relative absence of economies of scale, due to the smaller scale of

regional firms, and the need for greater adaptability and mobility of labour, of capital and of know-how. Specifically, regional firms will need to be able to adapt to the high technical standards of the larger market rather than depend on traditional relationships with established, often local, purchasers and they will need to develop a marketing capability appropriate to the needs of a wider, more competitive market.

82. The measures discussed, under non-discriminatory contract conditions and promotion of the participation of SMEs in public procurement, can be applied anywhere in the Community. Although, they may be more difficult to apply in the less developed regions, they are, nevertheless, of particular relevance to the problems of those regions. This appears clearly on close examination. Non-discriminatory contract conditions directed at the alleviation of unemployment or underemployment will have a particular relevance in areas where these problems are most serious. Those areas include in particular the declining industrial areas but also less developed regions of the Community. Similarly, measures to help SMEs participate in public contracts have a particular relevance to the less developed regions in view of the dominance of SMEs in the local economy. In addition, in both categories of less favoured region, it is small and medium-sized firms which frequently hold out the best prospects of growth. Further there exist possibilities in eligible areas for the Structural Funds to contribute towards the support measures outlined for SMEs.
83. Measures could be addressed to enterprises in particular regions to improve their participation in public procurement contracts, concentrating on established areas of vulnerability : planning and organisation; marketing; access to information about the wider public procurement market; access to capital and technical support; and improvement of labour and management skills.
84. Measures could include the introduction or expansion of advice and assistance mechanisms and services intended to help regional enterprises take the fullest advantage of public procurement. This could cover :
 - market research and services, including research and evaluation services for diagnosis of the capacities and potential of firms to respond to the needs of contracting entities;
 - the setting up of seminars and hearings related to specific potential public sector demands, allowing dialogue between public and private decision makers and encouraging the active participation of the latter;
 - assistance with product and process development, including financial aid such as under-writing of the development of new products designed to meet the needs of the public sector.
 - better dissemination of the results of the Community research programmes to regional enterprises and administrations;

- support for converting production to European technical standards and specifications, which are now becoming obligatory for contracting authorities; the provision of technical laboratories for testing and certifying conformity of products and processes with such standards;
 - technical assistance related to bid preparation for non-local contracts, including assistance with language problems;
 - facilitating access, perhaps via the European Investment Bank to capital needed for participation in public contracts;
 - reinforcement of the Europartenariat and other measures to encourage joint ventures, including participation of banks and financial institutions where FEDER guarantees are in operation;
 - training in marketing, including ERASMUS-type exchanges of managers to prepare them for the choice of specialization which the opening-up of public procurement may well impose on some regional enterprises;
 - vocational training related to changed production requirements.
85. Taking measures along those lines in particular regions would not preclude Community assistance to maximize the impact, where most needed, of certain of the proposals put forward for SMEs in Chapter IV.3.
86. Such measures could take the form of State aids. Such aids would have to be notified in accordance with the provisions of Article 93/EEC with a view to seeking their approval by the Commission.
87. It is clear that measures of this type should be prepared and executed in a way consistent with the ultimate objective of putting regional firms in a position to make serious bids for contracts, not only in their own regions, but also in the wider Community public procurement market. The aim is not to protect regional markets. Specific conditions might therefore need to be imposed by the Commission to ensure that the contacts established between contracting authorities and suppliers were not such as to distort the markets. It could be necessary, for example, to ensure that the public procurement function and the function of providing technical or financial assistance were kept strictly separate and, if necessary, carried out by separate bodies.

V. POLICY ON REGIONAL AND SOCIAL ASPECTS OF PUBLIC PROCUREMENT

88. As was made clear in Chapter II, the operation of the internal market is such as to create opportunities for businesses to exploit.
89. The Commission's concern, in developing its policy for social and

economic cohesion in the operation of public procurement, is to ensure that the opportunities for participation are widely spread among all groups and regions; and to assist the less advantaged to participate in the market and to exploit their opportunities to the full.

90. Thus whereas the creation of a transparent public procurement regime with readily available information facilitates participation, policies could be developed in favour of particular groups or regions positively to encourage them to exploit their capacities within the single public procurement market.
91. Such an approach does not admit of a simple policy decision which is self-executing - in the sense that the single market, once brought into existence, may tend to be. Rather, it requires the identification of a series of measures, which may be used in different combinations in different circumstances, and which may be put into effect at national, regional or local level with, where appropriate, Community measures too.
92. The following sections review each of the policy areas discussed in Chapter IV with a view to setting out the Commission's policy orientations.

V.1 Approach to the problem of regional preferences

93. The Commission intends to undertake urgent discussions with the Member States concerned with a view to bringing any infringements to an end at the latest by 31 December 1992. It will give priority to the elimination of infringements resulting from the operation of preferences above the thresholds in the existing directives⁽⁸⁾. In addition, measures to help regional enterprises to exploit fully the opportunities in the single market will also be explored. Such measures could include those outlined in the previous chapter on promoting greater SME and regional participation in public procurement (paragraphs 65 to 87).
94. It should be recalled that the thresholds in the directives have been fixed to identify the level at which there is a real prospect of cross-frontier trade. Following this line of thinking, it will be possible in certain cases to demonstrate that preferences operating in these circumstances are not economically significant. This will only be possible where the regime is, itself, transparent. Procurement regimes which simply reserve public purchases to national firms can hardly be regarded as falling within this category. Where a regime operates through a transparent mechanism such as second bidding or an acceptable price preference, in the range of 5 % to 10 %, however, the demonstration should be possible. The Commission will examine systems which operate below the threshold in terms of the transparency of the procurement mechanism and of the impact on trade and will adopt the appropriate decision.

(8) In the case of supplies contracts, the thresholds are 137,000 ECU for central government authorities covered by the GATT Code and 200,000 ECU for other authorities. The threshold for work contracts is being raised to 5 million ECU.

95. The Commission will present a report during 1995 on the operation of the regimes as modified and their effects on the Internal market.
96. The Commission, in its general approach to preference schemes, must also take account of the Community's international obligations under the GATT Agreement on Government procurement, adopted in 1980, and modified in 1987. The Agreement applies to the procurement of supplies above a threshold, at present equivalent to 137,000 ECU, by listed entities, which are in practice agencies of central government. The Commission, in particular, must take account of the provisions of Article 11 on national treatment and non-discrimination. With regard to preferences applied by central government entities questions might be raised as to their compatibility with Community obligations under the Code, when they have not been notified and accepted by the other Parties. The Commission will remain vigilant in ensuring that the Community's obligations in this connection are respected.

V.2 Measures to exploit the single public procurement market

a) Non-discriminatory contract conditions

97. The opportunities for the exploitation of non-discriminatory contract conditions under the Directives as presently drafted are, as was shown in IV.2, wide in scope but subject to limitations which can only be evaluated on a case-by-case basis.
98. Publicity in the contract notice for such conditions is in any case indispensable, as was made clear by the Court. On this basis, the Commission will strictly monitor use of such conditions with a view to ensuring that they do not infringe Community law.

b) Measures in favour of the participation of SMEs

99. As has been explained in section IV.3 above, a series of measures has already been taken with a view to assisting SMEs fully to exploit their competitive advantages within the public procurement market. The Commission will continue to seek ways of further developing such actions, including the communication referred to in paragraph 65.
100. Certain of these measures will be included in a draft Commission recommendation to Member States which will be the subject of consultation with the Advisory Committees on public procurement and interested parties.
101. The Commission will continue to work with the appropriate authorities with a view to developing a better information base concerning SMEs and the markets of potential interest to them. If necessary, it will make appropriate proposals. The Commission considers that the adoption of its proposal for the modification of the public works Directive⁽⁹⁾, which provides, where appropriate, for publication of the share of the contract which the winning bidder intends to put out to subcontract, would constitute a useful step in this direction.

(9) COM(89) 141 of 4 April 1989

c) Greater regional participation

102. Member States may include measures of the type indicated in both Chapter IV.3 and Chapter IV.4 above in the multiannual plans to be submitted under the Structural Funds Regulation (2052/88). These plans would then be the basis for Community support frameworks to be negotiated between the Commission and the Member States. The nature of the measures put forward would appear to be best suited to the European Regional Development Fund, the European Social Fund and, in certain cases, the European Investment Bank.
103. The Commission will examine, in the light of studies on the impact of public procurement and other studies concerning the internal market and measures proposed by Member States in the development plans and priorities included in the Community support framework, if it is necessary to initiate supplementary measures in favour of regions eligible for the Structural Funds, which face problems associated with the impact of the opening-up of public procurement and the achievement of the internal market.
104. The measures containing State Aids would have to be notified to the Commission under the term of Article 93 (3) EEC. The method of applying Article 92 to regional aids is set out in an explanatory memorandum published in the Official Journal of the European Communities (C 212 of 12 August 1988).

d) Conclusion : future work

105. Further work is necessary to develop action both within the context of the promotion of small and medium-sized enterprises (see paras 99 to 101) and of measures to assist regions in difficulty (see paras 102 to 104) and in other areas, where further study and discussion may be required. A co-ordinated work programme will embrace the following action :
- further guidance to Member States on the use of non-discriminatory contract conditions to pursue social objectives, in the light of developments in the practice of contracting authorities;
 - preparation of a detailed and comprehensive communication on SMEs and public procurement with a view to bringing forward proposals, where appropriate, such as :
 - . the improvement of the quality of information on contracts available to potential bidders;
 - . further clarification of the extent to which the Directives permit division into lots and sub-contracting;
 - . clarification of the legal status of sub-contractors;
 - . development of standard sub-contracting provisions;

- . In the light of a study recently carried out for the Commission, exploration of more favourable conditions for financial guarantees, including encouragement of systems of collective insurance to guarantee the solvency of enterprises;
- . development of more effective inter-SME and SME and non-SME co-operation, in particular, within the framework of the European Economic Interest Grouping (EEIG);
- finalisation of the proposed Commission recommendation on measures to promote the participation of small and medium-sized enterprises in public procurement, in the light of this Communication;
- the conclusion of the study on the need for accompanying measures in sectors previously excluded from the operation of the public procurement directives;
- the examination, in the light of studies on the impact of public procurement and other studies concerning the internal market and measures proposed by Member States in the development plans and priorities included in the Community support framework, of whether it is necessary to initiate supplementary measures in favour of regions eligible for the Structural Funds, which face problems associated with the impact of the opening-up of public procurement and the achievement of the internal market;
- further study of the operation of other measures, listed in para. 84, and in particular those aimed at improving the quality and flow of information between potential contractors and sub-contractors and contracting authorities including the development of electronic bidding information services;
- intensified regional dissemination of the results of research programmes relevant to public procurement;
- further examination, in consultation with the European Investment Bank, of the problems of access to capital needed for participation in public procurement.

REGIMES OF PREFERENCE IN PROCUREMENT IN FORCE IN THE MEMBER STATES

MEMBER STATE	LEGAL BASIS	C O V E R A G E a) Demand side b) Supply side	METHOD OF APPLICATION
FEDERAL REPUBLIC OF GERMANY	Federal Law	a) public contracts (supplies/works) b) enterprises producing or persons established within Berlin West or zone within 50 km of frontier with DDR.	- obligation to include (b) <ul style="list-style-type: none"> . in lists for selective tendering . obligation to give preference to (b) if equal lowest tenderer or within a percentage of 0.5% of lowest tenderer for contracts of 1.000.000 DM or more (Note : in case of Berlin regime of regional preference co-exists with turnover tax concessions which have a direct impact on tender prices).
GREECE	National legislation	a) public contracts (suppliers) b) (i) enterprises established in regions i.e. at a distance of more than 50 km from Athens	b) (i) up to 7% price advantage over lowest tender
		(ii) enterprises established in the Greek Islands	(ii) up to 10% price advantage over lowest tender

ITALY	National legislation	(a) Public supplies contracts (national and regional administration, public corporations); (b) enterprises established in Mezzogiorno, Latium, Trieste	30% quota allocated to regions indicated under (b), but with competitive tendering within quota. 50% quota for supplies for public works assisted from special intervention funds
UNITED KINGDOM	Regional	(a) Public works contracts of regional, local administrations, public corporations (b) enterprises established in Sicily for at least 3 years	<ul style="list-style-type: none"> - When price considerations equal 40% minimum participation of Sicilian enterprises - residential, school buildings : 25 % pre-fabricated building : material to be supplied by Sicilian enterprises - preferences for subcontracting
	Administrative practice (non-obligatory)	<p>A. General preference scheme</p> <p>(a) procurement of supplies by central government, nationalized industries, other public authorities; (b) enterprises established in listed development areas.</p> <p>B. Special preference scheme</p> <p>(a) Enterprises in listed development areas (b) Enterprises in listed development areas.</p>	<p>When price and other considerations are equal, public contracts let to (b)</p> <p>No price advantage, but qualifying firms (b) may be given opportunity of taking 25% of an order at a price which entails no additional cost to purchaser.</p>
	Administrative practice (non-obligatory but general in practice)	(a) procurement of supplies by Northern Ireland government departments (b) persons or enterprises trading Northern Ireland products	<ul style="list-style-type: none"> - general preference for Northern Ireland products given conformity with specifications; - 5% price advantage to tenderers, if of benefit to employment in Northern Ireland.

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