IDEAS
Institute for Democracy and Economic Affairs

January 2014

POLICY IDEAS Nº 10

Transparency in European public procurement: benefits and lessons for Malaysia

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By making the procurement process more open and equitable, transparent procedures can produce significant benefits for the public at large and for firms that are interested in bidding.

Executive summary

Malaysia has rather robust procurement regulations that compel agencies to implement the principles of transparency, value for money, and fair dealings in procurement activities. However, there are areas in which Malaysia can improve especially to encourage competition and innovation.

The paper outlines measures that can be adopted by the Malaysian government to improve the competitiveness and transparency of its procurement system. These measures are inspired by the European Procurement system that is explored in the first part of the paper along with the benefits associated with greater transparency in public procurement.

Transparency is one of the core principles in EU procurement. It is required in all stages of procurement, but particularly in three phases of *tendering*, *evaluation* and *review* in order to ensure non-discrimination and equal treatment. The paper describes how the principles of transparency is applied in these stages.

The four measures advocated by the paper are as follows: (1) contracting agencies should add clearer and more detailed evaluation criteria in tender notices or tender documents, (2) contracting agencies should provide information about the reasons for choosing certain contractors and rejecting others to both winning and losing contractors as well as to the public, (3) a review phase should be incorporated into the system to allow contractors to file for complaints if they are not happy with the decisions made by the agencies and (4) the government should create parameters to ensure Bumiputera preferences in government procurement are less distortive to competition and are awarded in a transparent manner.

This paper has two goals. The first aims to argue for increased transparency in Malaysian public procurement by bringing to the fore the benefits associated with greater transparency in public procurement. The second is to propose several measures that can be adopted to improve transparency in Malaysian public procurement by introducing the public procurement regime of the European Union (EU).

1. Benefits of transparency in public procurement

Transparency in public procurement "refers to the publication, notification, and dissemination of pertinent information about a procurement regime to actual and potential bidders and to the public at large" (Evenett and Hoekman 2004, 7). Therefore, although in principle transparency can pertain to all phases of public procurement, it is most immediately relevant for the phases in which the procuring authority interacts with bidders and the public at large, i.e. tendering, evaluation and review.

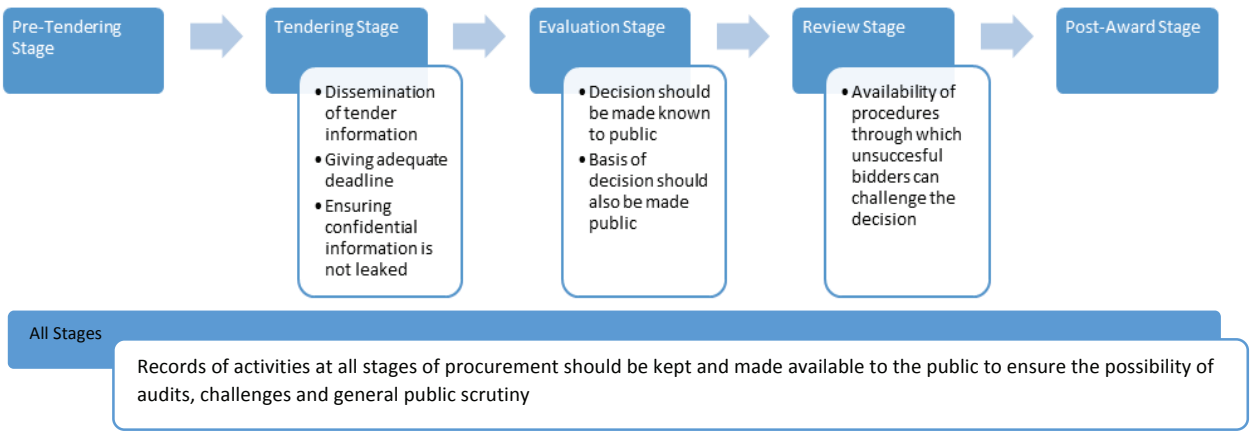
At the tendering stage, transparent public procurement regimes provide for the dissemination of information on the tender, including the procedure and criteria that will be used in the award process, giving adequate deadlines to the potential bidders, and ensuring that confidential information is not leaked to preferred bidders. *At the evaluation stage*, transparency refers to the degree to which the decision is made public and on what it is based. After the project is awarded (*review stage*), there should be procedures through which unsuccessful bidders can challenge the decision of the procurement officials. Finally, at all stages of the procurement cycle records should be kept and made available to the public, so as to ensure the possibility of audits, challenges and general public scrutiny (Evenett and Hoekman 2004, 10-12; Evenett and Hoekman 2005, 3; OECD 2003, 6-7; OECD 2009, 21-29).

By making the procurement process more open and equitable, transparent procedures can produce significant benefits for the public at large and for firms that are interested in bidding. With regard to the latter, by making the procurement process fairer and more predictable and open to scrutiny, transparency reduces the risk for bidding firms, as they are better able to assess the costs and opportunities of bidding. This may increase the number of domestic firms, including Small and Medium Enterprises (SMEs) that may find it worthwhile to bid. Competition between local suppliers can thereby be nurtured and their innovation and efficiency skills can be improved. This will enable them to enter the international market (OECD 2003, 7-8).

For the public at large, increased transparency, by facilitating competition, means that suppliers will bid more aggressively, thus reducing prices and producing savings in public spending that can create scope for tax decreases or more extensive government services (Evenett and Hoekman 2004, 6).

Moreover, greater transparency means faster economic growth. The connection between higher transparency in public procurement and faster economic growth is based on three causal channels: increases in competition, increases in Foreign Direct Investment (FDI), and decreases in corruption.

Diagram 1: Transparency at all stages of procurement

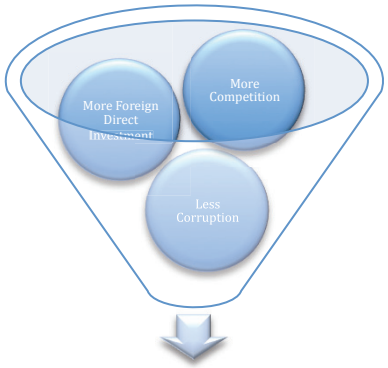


First, increased competition spurs increases in efficiency and productivity, thus raising income growth rates (Lewis 2004). Second, as foreign investors will find it easier to assess market opportunities in a country with transparent procurement procedures and where they will be assured that their products and services are not discriminated against by public entities, transparency creates the conditions for an increase in FDI (OECD 2003, 7), which in turn increases productivity and growth (Borensztein et al. 1998). Finally, transparency can be expected to reduce corruption in public procurement. As corruption negatively affects growth, reducing corruption in public procurement offers an important avenue to spur economic growth. Corruption reduces growth by reducing the quality of government services and infrastructure and by skewing the composition of government expenditure, for instance reducing spending for maintenance and for services, such as education, that are highly important for growth but give little opportunity for corruption, and increasing spending for large infrastructural projects that are not needed but which offer ample opportunity for illicit gains to the providers and the personnel who made the procurement decision (Mauro 1998; Tanzi and Davoodi 1997).

In general terms, corruption is a function of the rents available to the potential bribe-givers and bribe-takers (Mauro 1998). In the case of public procurement, rents derive from the overpricing of the products, works or services provided to the public entity purchasing them, namely from terms, with regard to prices and/or quality, that are worse than market terms (Pashev 2011). Transparency, by allowing the public to monitor the decisions of the purchasers and the performance of the suppliers (OECD 2006, 55), reduces the gap between the market terms and the terms of the public purchase (the rents), and thus reduces the scope for corruption (Evenett and Hoekman 2005, 28; OECD 2003).

Research exists that quantifies the impact of transparency on the number of bidders and on public sector savings. In a sample of contracts in the EU Member States in the 2006-2009 period, increases in openness in the procurement process through the use of the open bidding procedure and the publishing of Prior Invitation Notices (PINs) to alert potential bidders of upcoming procurement opportunities and of Invitations to Tender (ITTs) have increased the number of bidders by more than 45 percent and reduced the costs of procurement by 4 percent (Europe Economics 2011). It should be noted that the savings results are consistent with research carried out in other settings: Duncombe and Searcy (2007) find that open bidding reduced the costs of public procurement in the New York State school system by approximately 4 percent, while an analysis of public procurement in Japanese local government concludes that the introduction of transparent qualification procedures reduced the costs of public procurement by 8 percent of the value of the winning bids (Ohashi 2009).

Diagram 2: Relations between higher transparency and economic growth



Based on this research, we can attempt a rough estimate of the potential savings for Malaysia by increasing the transparency of its public procurement regime. We use the estimate for the EU reported above, i.e. 4 percent savings from using open bidding procedures and PINs and ITTs, all areas that are insufficiently developed in Malaysia (Jones 2013), and the most recent internationally available data on the size of public procurement expenditure in the country, which put it at 12 percent of Malaysia's GDP in 2009.[1] Applying these values to Malaysia's GDP in 2012, RM946 billion,[2] and assuming that at present only 50 percent of public procurement in value meets the procedural (open bidding instead of direct contract awards or negotiation) and information standards of the EU regime, would place the estimated savings from adopting the EU standards at around RM2.3 billion per year. Table 1 shows the formula used to arrive

1 "Source: http://madb.europa.eu/madb/barriers_details.htm?barrier_id=105343&version=5
2 Source: http://www.worldbank.org/en/country/malaysia. The exchange rate used to calculate the GDP is USD1=RM3.1

at this assessment, while Table 2 provides estimates of potential savings for different assumed levels of non-transparency in Public Procurement.

2. The EU public procurement regime

The EU began regulating public procurement as early as 1971, which makes the EU public procurement regime one of the oldest internationally. The EU regime is also the inspiration, among others, for the World Trade Organization's (WTO) Agreement on Government Procurement (GPA) (Arrowsmith 2009). In this section we describe the fundamentals of the EU public procurement regime and how they are articulated with regard to the tendering, evaluation and review phases of the procurement process.

2.1 The fundamental elements of the EU public procurement regime

The current regulatory regime is based on three Directives (2004/17/EC, 2004/18/EC and 2007/66/EC) and the case-law of the European Court of Justice (EJC). The rules that are currently in force are a response to the problems that were seen in European public procurement in the 1990s, and which can all be connected to insufficient transparency: excessive use of negotiation, low quality of notifications to firms, excessive use of accelerated procedures, excessively short deadlines, amendments being made to the tender specification during the tendering procedure (European Commission 1996). Moreover, the European commission issued a draft Directive to reform the EU public procurement regime in December 2011 (COM (2011) 896 final). This draft was issued to respond to debates on how to reconcile flexibility and transparency, the use of public procurement for goals other than market integration, and how to ensure maximum participation by SMEs. As its final approval is expected in the next few months (Council of the European Union 2013), we refer to it in the text so as to include in our discussion the new elements that will soon come into force.

The fundamental principles of the EU public procurement regime (see for instance Recital 46 of Directive 2004/18/EC) are *transparency*, *non-discrimination* (of foreign nationals) and *equal treatment*, the latter referring to the obligation of contracting authorities not to treat comparable suppliers differently (Arrowsmith 2009).

Transparency, specifically, is required in the three phases of *tendering*, *evaluation* and *review* in order to ensure non-discrimination and equal treatment. The essential goal is to maximise market integration (Arrowsmith 2009) and hence competition. Improving competitiveness, in turn, is the key strategy for economic growth of the EU, and public procurement plays an important role in this (European Commission 2010).

The current Directives and the jurisprudence of the ECJ already

Table 1: Formula to calculate potential savings from transparent procurement regime

GDP x (PP/GDP) x (Non-transparent PP/Total PP) x 4%

GDP: Gross Domestic Product ■ PP : Public Procurement

Table 2: Potential savings for Malaysia with different assumption on non-transparent public procurement

GDP (2012)	Public Procurement (12% of GDP) (2009)	Assumption of Non-transparent PP as a Share of of Total PP	Potential Savings
RM 946 billion	RM113 billion	10%	RM454 million
		20%	RM908 million
		30%	RM1.4 billion
		40%	RM 1.8 billion
		50%	RM 2.3 billion

make it clear that contracting authorities may pursue goals other than increased competition when structuring their procuring processes, in particular with regard to environmental considerations and social inclusion, as long as they do not use these criteria to distort or limit competition (Bovis 2006, 42; Trepte 2005, 364). Specifically, environmental or other considerations should be directly linked to the subject matter of the contract and be explicitly included into the contract notice as technical specifications for selection and the award of the contract and as contract performance clauses. Ultimately, these broader, non-market considerations should thus be part of the parameters used to choose the most economically advantageous tender (European Commission 2004; European Commission 2011a).

Although it is only supposed to provide a framework for the EU Member States, the EU regime has become increasingly binding as EU legislation has become more detailed (Arrowsmith 2009). Moreover, although EU rules only apply to contracts above certain specified value thresholds (Art. 7 of Directive 2004/18/EC), its basic principles, such as transparency and non-discrimination, have been extended by the European Court of Justice (ECJ) to all public procurement contracts irrespective of their value if they have a cross-border interest (European Commission 2011a). In any event, Member States tend to apply the same tendering procedures as for contracts above the thresholds, although reducing the time limits for the submission of applications and lightening some requirements regarding the publication of tenders and the selection of candidates (European Commission 2011b, 53).

Even though the EU rules focus mainly on the tendering, evaluation and review phases, they do also make some reference to both the planning and execution phases, with a view to increasing their transparency. With regard to the planning phase, Art. 35 of Directive 2004/18/EC mandates that contracting authorities shall make public their buying plans for the coming budget year through information notices, whose content is regulated by the Directive. With regard to contract execution, the same Directive mandates that the execution clauses must be specified in the contract notice.

The directive also covers framework agreements for repeat purchases, dynamic purchasing systems for electronic purchases, and design contests for architectural, urban, engineering and data processing plans, all to follow the procedures just mentioned according to the applicability conditions detailed in the Directive.

2.2 Standard and Special Procedures

Open and *restricted* bidding, the latter known internationally as pre-qualification procedure, are the standard procedures. In limited cases, detailed in Directive 2004/18/EC, contracting authorities can make use of *negotiated procedures* (competitive negotiation in international parlance)[1] and of the "*competitive dialogue*[2]".

Negotiation and competitive dialogue are allowed when:

1. the contract regards both design and execution,
2. "negotiations are needed to establish the legal or financial makeup of the project",
3. in the case of service contracts, the technical specifications cannot be defined with sufficient detail with respect to the existing technical standards,
4. the contract is of such complexity that it cannot be awarded without prior negotiation,
5. the contract has research or development purposes, and
6. the previous open or restricted tender has elicited only irregular or unacceptable tenders.

In order to ensure that the greater use of the negotiated procedures is to the advantage of the public procurement agencies, and especially considering that sub-national authorities often do not

1 New Negotiated procedure is a procedure that allows a negotiation between one or more tenderers with the contracting authority, but the requirements of the projects are already detailed in the contract notice.
2 Competitive Dialogue "is a procedure in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements, and on the basis of which the candidates chosen are invited to tender" (Art. 11 of Directive 2004/18/EC). This procedure is to be applied in especially complex contracts, when the specifics of the contract cannot be defined at the time of tendering, i.e. when the contracting authority is not even sure of the best way to achieve its means.

"have have the necessary technical expertise, knowledge of the market and skills to negotiate a good deal with the suppliers" (European Commission 2011a, 20), the draft Directive mandates the creation of national "knowledge centres," for the technical support of contracting authorities. The knowledge centres would also provide technical support to the firms that require it. For firms, the Commission also proposes allowing self-declarations at the moment of bidding (save the presentation of all the required documents as a condition for the award of the contract).

2.3 Application to the tendering phase

With regard to the *tendering phase*, as a rule contract authorities must publish a contract notice with complete information for bidding, detailed in Directive 2004/18/EC, and give enough time to interested firms to respond, with minimum time limits specified in the Directive (e.g. for the open procedure at least 52 days from the publication of the contract notice).

Notices must be sent in a standard form.[1] To ensure uniformity, contracting authorities can use forms provided at the European Union Public Procurement website (www.simap.eu.int).

In the case of restricted tenders, the ECJ has ruled that the contracting authority must make available to tenderers a detailed description of the methodology it uses to select the participants in the bid (Arrowsmith 2009). In the case the criterion chosen for awarding the contract is best value for money (see below), the contract notice must include the formula adopted by the contracting authority and the weight given to each element.

2.4 Application to the evaluation phase

The *evaluation* of bids can only be made based on one of two criteria: "lowest price" and "most economically advantageous tender," i.e. best value for money, which takes into account a number of elements such as delivery time, after-sales support etc. (Art. 53 of 2004/18/EC).

In the case of restricted bids, the ECJ has ruled that the selection and award phases must be kept independent in order to separate the assessment of the quality of the bid from the that of the ability of the tenderer to deliver, the rationale being that mixing the two assessments "could undermine the comparability of the factors to be taken into account and ultimately infringe the principle of equal treatment" (European Commission 2011a, 17). However, the draft Directive proposes that, while the two phases should be kept distinct, the contracting authority can decide how to sequence them.

In the evaluation process, contracting authorities should be allowed to exclude tenderers if they have consistently or significantly failed to deliver on their obligations arising from previously awarded contracts.

2.5 Application to the post-award phase

With regard to the post-award phase, the EU legislation requires that the contract must include the entire winning bid (Pashev

In the evaluation process, contracting authorities should be allowed to exclude tenderers if they have consistently or significantly failed to deliver on their obligations arising from previously awarded contracts.

1 http://simap.europa.eu/docs/simap/pdf_jol/en/sf_002_en.pdf

2011). Moreover, as per the ECJ case-law, amendments to the contract provisions after it has become operative are not allowed and require a new tender if "they introduce conditions which would have allowed the participation or the success of other tenderers, if they considerably extend the scope of the contract or if they change the economic balance of the contract" (European Commission 2011a, 25).

However, the draft Directive introduces the possibility for contract modifications under clearly specified conditions, e.g. when the value of the changes is below a certain threshold, if the tendering documents already included clear review clauses, and in the case of unforeseeable developments affecting the performance of the contract.

The current Directives rule that notice of the award results must be sent within 48 days of the award, and tenderers who have not been awarded the contract have the right to request the rationale behind the decision. The Directive outlines details of information that contracting authorities should include in the award notice.[1]

Like the contract notice, contracting authorities have to follow a standard award notice format that can be found in the European Union Public Procurement website. In addition to names of the awardee and the value of contract, the award notices should contain information about award criteria and procedures for appeal.

Furthermore, the contracting authority must prepare a report on the awarding procedure which the European Commission can request, and which must include the name of the successful and unsuccessful tenderers and why they were or were not awarded the contract.

2.6 Application to the review phase

The *review phase* is covered by the Remedies Directive (2007/66/EC), itself amending previous remedies legislation. The overall goal is to ensure that economic actors can resort to remedial action before the contract is signed (European Commission 2006). The bodies in charge of the review procedures must have the power to issue interim relief measures, set aside unlawful decisions and award damages; in order to safeguard their independence, these bodies must either be judicial in character or have judicial features with regard to the appointment process and qualifications of their personnel.

Furthermore, in order to contrast the practice whereby contracting authorities proceed very quickly to sign the contract so as to make it irreversible (European Commission 2006), this directive has introduced a "standstill period," namely a period after the award of a contract in which its conclusion is suspended, so as to allow affected tenderers to have access to judicial protection.

Two implementation problems with regard to the review phase are worth noting. First, firms may refrain from applying for remedial action because they might be afraid that they will then be open to retaliation, such as the exclusion from future tenders, by the contracting authority (European Commission 2006; Lemke 2003). Second, and also an issue that might limit firms' willingness to make use of legal remedies, the remedial proceedings may be very long, especially if they are the responsibility of the ordinary court system. For this reason, although the Remedies Directive does not mandate it, setting up an independent authority, or an independent unit within an existing organisation, was the European Commission's preferred option (European Commission 2006). While some Member States have in fact opted for this solution (see section 3), others, such as France and the Netherlands, have chosen to maintain the competence of courts over public procurement cases, but to nonetheless make the proceedings faster by mandating shorter deadlines or faster procedures (European Commission 2012, 21).

The Commission finds that the monitoring and oversight structures of the Member States (see section 3 below) remain of varying quality. It thus urges that each Member State have a single national oversight body,[2] and that high-value contracts should be sent to it and be available for examination by any interested party in order to fight corruption and fraud.

1 http://simap.europa.eu/docs/simap/pdf_jol/en/sf_003_en.pdf

2 Its tasks should include: "(a) monitoring the application of public procurement rules and the related practice by contracting authorities and in particular by central purchasing bodies; (b) providing legal advice to contracting authorities on the interpretation of public procurement rules and principles and on the application of public procurement rules in specific cases; (c) issuing own-initiative opinions and guidance on questions of general interest pertaining to the interpretation and application of public procurement rules [...]; (d) establishing and applying comprehensive, actionable 'red flag' indicator systems to prevent, detect and adequately report instances of procurement fraud, corruption, conflict of interest and other serious irregularities; (e) drawing the attention of the national competent institutions, including auditing authorities, to specific violations detected and to systemic problems; (f) examining complaints from citizens and businesses on the application of public procurement rules in specific cases and transmitting the analysis to the competent contracting authorities, which shall have the obligation to take it into account in their decisions or, where the analysis is not followed, to explain the reasons for disregarding it" (Art. 84 of draft Directive).

3.0 Lessons and recomendations for Malaysia

Several measures discussed above have also been applied in Malaysia. Malaysia has rather robust procurement regulations that compel agencies to implement the principles of transparency, value for money, and fair dealings in procurement activities. Rules issued by the Ministry of Finance for agencies to carry out different procurement methods are quite clear and aim for the procurement process to be effective and efficient. Open tenders, for example, are supposed to be the default option for all procurement projects that cost more than RM500,000. Only in special circumstances are agencies allowed to procure works, services and goods through restricted tenders and direct negotiations. The Ministry of Finance's approval is required to carry out procurement through direct negotiation.

However, there are areas in which Malaysia can improve by learning from the European experience.

First, Malaysia can improve its tendering process by providing more comprehensive information, particularly about evaluation criteria and the weightage given to each criterion in tender notices or tender documents.

Tender notices are currently advertised by procuring agencies in local newspapers, their websites and procurement related portals such as e-perolehan, NeTi and Myprocurement. For local tenders, the notices are required to be up for 21 days, and 56 days for international tenders, 4 days longer than the EU period. The information that is required to be included in the notice are as follows: the name of the department, tender title, tenderer eligibility conditions, place, date and time of the sale of tender documents, price of tender documents and how and to whom payment is made, place, date and time to receive and close the tender and the date of site visits, if applicable.

Tender documents on the other hand are documents that are available for purchase for any interested contractors or suppliers. The documents explain how the tender process will be carried out including the criteria that will be used to evaluate the bidding documents. It also contains instructions for tenderers on how to submit bidding documents, information on deposits, project briefings, and samples of contract documents.

Tender documents mention that the selection will be based on technical and financial evaluation. Some may mention that the award will go to the lowest price but technically-qualified bidder. However, information about weightage given to each criterion is not mentioned. The documents only specify that the relative weighting of each criteria and the formula used to calculate the criteria are "pre-determined and well-defined".

Looking into SIMAP, the European Union Procurement Portal, it is clear that such information is available in contract notices, especially for sophisticated projects. A contract notice issued by Network Rail Infrastructure Limited for procuring support service for railway transport, for example, listed these criteria for selection and the weightage given to each.

Such information is important because apart from the price factor, several other criteria are also taken into account. Among them are: that the offer made meets the prescribed specifications; the ability of the tenderer to meet contractual obligations; financial position; experience and so forth. Therefore, the tenderer offering the lowest price is not necessarily the one chosen if the bid does not meet the selected evaluation criteria set.

It is important to release such information in advance in order to prepare the contractors for bidding and to avoid confusion and unnecessary criticism. If questions emerge on the award later, all parties concerned and affected by the decision can refer to the document.

Table 3: Information on Criteria and Weightage in EU Tender Notice

Criteria	Weightage
General	Pass/Fail
Key Requirements	Pass/Fail
Expertise and Experience	70%
Contractual	Pass/Fail
Health, Safety and Environment	10%
Quality and Management	10%
Equality and Diversity	5%
Sustainability	5%

Second, Malaysia can improve its awarding process by providing information about the reasons for choosing certain contractors and rejecting others. This information first and foremost should be available to both winning and losing contractors. They both deserve to know the reason for winning or losing the bid. However, as is the current practice and stated in many tender documents, the Malaysian government has every right to not inform the bidders as to the reason for either accepting or rejecting their tenders.

Third, Malaysia can improve its procurement process by incorporating a review phase that allows contractors to file complaints if they are not happy with the decision made by the agencies. The current practice is that objections are only allowed within the first 28 days (for international tenders) or 14 days (for local tenders) of tendering. Tenderers can submit objections to the agencies if they see that the specifications delineated in the tender documents favour certain bidders. No objections are allowed after that, including objections to tender awards.

Fourth, the European Union does not rule out the possibility of including social inclusion as one of the objectives when procuring public goods. It rules, however, that such inclusion should not distort or limit competition and because this is used as a parameter to choose the most economically advantageous tender, the weightage given to social inclusion should be specified in the contract notice. Bumiputera preference is an integral part of Malaysia's procurement system. Malaysia can learn from the European Union system to ensure such preferences are not distortive to competition and are awarded in a transparent manner.

Bumiputera preference is an integral part of Malaysia's procurement system. Malaysia can learn from the European Union system to ensure such preferences are not distortive to competition and are awarded in a transparent manner.

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