Division of Public Contracts into Lots and Bid Rigging: Can Economic Theory Provide an Answer?

KEYWORDS: Public Contracts, Economic Contracts, Small Business, Market Entry, participation

TYPE OF PUBLICATION: Journal Article


BACKGROUND

- Within the public sector large contracts are often split into smaller contracts or “lots” which are then bid for by participants.
- This generally enhances competition by improving participation from smaller businesses however it may also cause bid rigging.
- Big rigging is when participants conclude to choose the winner of a lot. This can cause an increase to budgets and taxes with no positive impact on society.
- Economists has established two rules to help deal with bid rigging:
  - Rule One: Having a number of lots smaller than the number of total participants
  - Rule Two: Reserving at least one lot for new participants

METHODOLOGY

- The paper reviews the legal framework for division of public contracts in Europe.
- It then evaluates the effectiveness of rule 1 and rule 2 in practice.
- It then makes suggestions on how the process of bidding on lots could be improved.

KEY FINDINGS

- Rule one doesn’t always work in practice as the market can be more complicated than economic theory suggests. For example; firms often compete in multiple bids, subcontract bids to other firms, or are allowed to withdraw from bids.
- Rule two is not always followed in practice. National Authorities have a large amount of freedom under EU law to decide if they wish to follow rule two or not. Data suggests only 7 out of 28 EU countries have a desire to treat small businesses preferentially which suggests most countries would choose not to follow rule 2.
POLICY ISSUES

- Economic theory is not a panacea for reducing bid rigging, the findings suggest real world markets are more complicated than rule 1 and rule 2, however bid rigging could potentially be reduced by:
  
i) Reducing the amount of information about how a bid is split into lots.
  
ii) Stricter Regulation of bid withdrawals or forbidding them entirely.
  
iii) Better regulation on pricing strategy when lots can be bundled.
  
iv) Increasing awareness by issuing guidelines for procurement officers on bid rigging, and by ensuring they review the potential for bid rigging before splitting a contract.

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