THE POLITICS OF PROCUREMENT

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Abstract

It seems generally to be assumed that developing countries are all very similar. When it comes to policy decisions regarding them, a 'one cap fits all' is often applied. This concept is challenged by looking at the construction industry in Trinidad and Tobago, in the context of construction in developing economies. A review of procurement methods and construction delivery systems in Trinidad and Tobago draws on the broad principles outlined in the new institutional economics.

The defining role of institutions and the critical impact of the choices made by decision makers in economic development are highlighted. It is argued that procurement systems define the institutional matrix in the construction industry. Definitions of development and growth are cast in institutional terms thus setting the agenda for future study.

Keywords: Institutions; Procurement; Uncertainty; Developing Countries.

Introduction

A key issue regarding construction in developing economies is that "infrastructure development and economic development can not be separated for analytical purposes. They are as inseparable as opposite sides of the same coin" (Miller, 2000). Economic development includes the growth of gross domestic product but also includes a whole range of social improvements as well. Infrastructure development includes the provision of facilities to meet human needs, such as for the movement of people, goods, and information; in addition to the provision of water, sanitation, and shelter. The development of infrastructure facilities is symbiotically linked to economic development. The way the economic system develops will determine how infrastructure development takes place, just as the infrastructure itself limits or promotes the economic development it is dependent on – they are as interdependent as the chicken and the egg.

The iconic examples of recent economic development - Singapore, South Korea, China, Malaysia, and India - are all countries that focused attention on developing their physical infrastructure. At the same time, they recognised the importance of modern institutions in enabling progress and they built and developed their existing institutions accordingly. The lesson to be taken from this experience is that developing economies must focus not only on infrastructural improvement but also on the provision of appropriate institutions and organisations, especially in the construction sector - see for example, World Economic Forum (2007) or Francois and Manchin (2007).

The role of institutions in economic development is highlighted by Nobel Prize winner Ronald Coase “Economists have never considered until recently the role that institutions play in the working of the economic system. In fact, the institutions determine the way in which the economic system works” (Coase, 1997). By the same token, it is clear that the institutions will also determine the stage of development attained, and that is attainable, by a given country.

Coase (1937) also recognised that price mechanism alone is insufficient to explain the workings of markets, particularly when transaction costs occur (as they always do to a greater or lesser extent), and the allocation of resources results as much from administrative decisions as from relative prices. In other words, firms need to perform their administrative and co-ordinating,functions effectively and at a lower cost than their competitors in order to be competitive.

Coase (1997) added “To have an efficient economic system it is necessary not only to have markets but also … organizations of the appropriate size. What this mix should be we find as a result of competition.” In developing countries, firms and other organisations, are almost inevitably smaller than those in the developed countries, at least in part because of the size of their total, local markets and the normal size of a ‘typical’ project there. Firms in the developed world have grown to a size suitable for operating in the international market place and for dealing with mega-projects, hence, their planning capabilities are optimised and their transaction costs have been reduced to a level necessary for effective international competition. The smaller firms from the developing world thus cannot be competitive when it comes to bidding for larger projects that are let on equal terms (a ‘level playing field’) in an international market place.

All developed countries have recognised this as a possible ‘negative externally’ of the workings of the market and introduced trade restrictions to protect their local firms while they were themselves developing;thereby tilting the field in favour of the home ‘team’. This was done either by restrictive legislation, by a subsidy or some form of preferential treatment, or by a tax on foreign firms (leading into the issues of ‘least harm’ that Coase (1960) discussed in his famous paper “The Problem of Social Cost”). The rules of the World Trade Organisation have been specifically written to now close this option off from developing countries –a case of ‘do what I say not what I did’.

Capital

It is widely recognized that investment is the key to industrial growth and modernization, and that investment itself depends on the availability of accessible capital. De Soto (2000) highlights the role of capital in development - pointing out that one of the mysteries to address is why poor countries do not make better use of the capital assets they already possess. As he points out, the value of the real property, assets and savings, among the poor is considerable but that these assets are generally ‘dead capital’. For example, normally, one of the missing institutions is an effective mortgage system that would allow the capital tied up in property to be used as security to enable reinvestment. When lesser developed countries do have such a system it is generally foreign in origin and does not take effective account of the needs of the poor. This use of long-term real assets as collateral, that could make money available for use now, does not happened by chance in the Western world. “Every parcel of land, every building, every piece of equipment, or store of inventories is re-presented in property documents that are the visible sign of a vast hidden process that connects all these assets to the rest of the economy…They can be used as collateral for credit. Mortgages are the single most important source of funds for new businesses in the United States” (de Soto, 2000). Obviously for such a system to be effective one of the essential institutions is a well established system of land tenure and ownership – for ex-colonial countries, that emerged from slavery or indentureship, this may not be the case. The common and long-standing complaint by entrepreneurs (and contractors in particular) in Developing Countries, that the local banks do not provide the financial backing that they need, can be traced to this underdeveloped property market and the consequent inaccessibility of capital locally.

Institutions and Organizations

It is necessary to set out some important distinctions between:

(a) Institutions and Organisations
(b) Procurement Processes and Delivery Systems.
(c) Development and Growth

(a) Institutions and Organisations

- Institutions are the humanly devised constraints that structure human interaction. Institutions are the rules of the game within which individuals operate. Institutions are made up of formal constraints such as rules, laws, and constitutions as well as informal constraints such as norms, conventions, and codes of conduct with their respective enforcement characteristics. The central purpose of institutions is to reduce uncertainty that pervades all societal interaction (Dequech (2001)).
- Organisations are the players. Organisations are made up of groups of individuals bound by some common purpose to achieve specified objectives. An organisation may be a firm, a regulatory agency, a trade union, a political party, or any of the many and varied community and non-governmental bodies. As North (1993) noted in his Nobel lecture "The relationships between organisations and institutions are such that the organisations that come into existence reflect the opportunities provided by the institutional matrix… Institutions form the incentive structures of a society and the political and economic institutions, in consequence, are the underlying determinants of economic performance. If the institutional framework awards piracy, piratical organisations will come into existence; and if the institutional framework rewards productive activities, then organisations/firms will come into existence to engage in productive activity."

(b) Procurement Processes and Delivery Systems

- Procurement processes set the rules for the accomplishment of a specified purpose, such as the acquisition of property, works, and or services by a public or private entity. Procurement processes begin with the identification of a need and end with the fulfillment of a contract.
- Delivery Systems identify the type of contractual relationships used. In the construction industry delivery systems include, Sequential Design-Bid-Build, Design-Build, Turnkey, Build-Own-Operate-Transfer, Design-Build-Operate, Construction Management, and Design-Build-Finance-Operate, for example. The important issue is that different delivery methods require different procurement processes as well as different institutional and organizational arrangements. The relationship between procurement systems and delivery systems is such that procurement systems set the rules of the game in which organisations and delivery systems are chosen and operate, they establish a procurement route, delivery system, and contract strategy, as well as the operational relationship between the organisations in the supply chain. Delivery systems, on the other hand are differentiated mainly in terms of risk allocation, constraints, and the integration of the processes in the supply chain.

(c) Development and Growth

- Development implies improvement of the characteristics that define human welfare in that specific culture. It is a process of change that involves uncertainty and complexity. Favorable institutions are thus those that address uncertainty and complexity, and that encourage economic growth and social improvement such as trade, productive entrepreneurship, individual responsibility and individual preferences, risk taking, and competition (Colombatto, 2005)
- Growth is an increase in economic well-being; it requires the existence of an enabling institutional environment. Economic growth implies change in consumers' surplus rather than, necessarily, in purchasing power. Economic growth depends on the ability to

produce products and services that people will buy, and in the longer term, in the ability to transform technological advances into such products or services.

Institutional Change

Institutional change is apparent when the operating rules change and is evident in the choices made by decision makers, whether from inside or outside the country, that impact upon that country. In developed countries with sophisticated institutional arrangements, a wide range of decision-making can be accommodated without conflict. In developing countries, however, changes in the decision-making process may require the institutional arrangements to change. Hence, in construction, new forms of contract, new rules, codes, and norms of behavior may be required to accommodate a change to international procurement, for example. Such changes in the institutional environment can affect procurement processes and organizations, which in turn can determine contract forms and delivery systems.

Construction in emerging economies is focused essentially on change; change in the nature of the built environment, in the quantity and quality of the structures, facilities, and services provided. These changes almost always require foreign finance whether as grants, loans or as direct investment, and this almost inevitably causes changes to the institutional arrangements. Since the infrastructure development has a symbiotic relationship with economic growth and development, the way in which the institutional changes affect delivery and procurement processes are of critical importance.

The Caribbean

The Caribbean construction industry, over the past half century or so, has made concerted efforts to modernize the built environment to meet the needs of economic growth. This has particularly been the case with the improvement of the totally inadequate infrastructure inherited from colonial times. This process was handicapped throughout the islands by a lack of finance. Most of the countries had (and still have) economies structured almost entirely around the export of raw materials and unprocessed agricultural produce, and there was very little ‘active’ capital. In order to find the money needed to develop the infrastructure, governments had to approach the International Funding Institutions (IFIs).

By and large, the IFIs provided the money but it came bundled with their ideology, their cultural, economic, developmental, and institutional beliefs. It was not culturally value-free. This inherent ideology was characterised by De Soto (2000) as “American and European leaders… repeat to the rest of the world the same wearisome lectures: Stabilize your currencies, hang tough, ignore the food riots, and wait patiently for the foreign investors to return… Foreign investment is, of course, a very good thing. The more of it, the better. Stable currencies are good, too, as are free trade and transparent banking practices and the privatization of state-owned industries”. This ideology was encapsulated in the ‘structural adjustment’ requirements of the International Monetary Fund, which demanded of borrowers that they adopt a free market approach with an emphasis on the private sector and open international competition, particularly for the delivery and operations of infrastructure (see for example, the Wikipedia (2008b) or for a more extreme view, Shah (2007)).

The symbiotic relationship between institutional and economic development gives great power to those who make and change the rules (the decision makers) because they determine the incentives in the procurement processes that motivate the thrust to blind efficiency, social equity, or piracy. The overarching issues affecting construction in emerging economies (particularly in the Small Island Developing States (SIDS) like the countries of the Caribbean) are those dealing with:

- The lack of sensitivity to local institutional issues by decision makers.
- The local decision maker’s attitude to the demands of the polity.
- The local decision maker’s concept of development.
- The constraints associated with the financing of infrastructure development.

- The incentive arrangements in procurement systems over which decision makers wield considerable influence.

It is no accident that the literature on procurement deals, essentially, with methods to improve efficiency, social equity, and the avoidance of corruption; which are the issues of the developed world. The issues of the developing world need more focus on the implications of the prevailing institutions and the 'mental map' of the decision maker, and how, in a given social and historical context, these affect the implementation of change. Since construction is the major instrument of change in the developing world, it should be the centre of such a focus.

In the SIDS (like those of the Caribbean) change is restricted by the availability of money, as well as by the constraints associated with the money that is available. Thus, the role of finance and the incentive arrangements in the procurement system (that are determined by the decision makers) will be to 'map' the boundaries of efficiency, capacity development, social equity, and piracy in that context.

Politics of Procurement

Politics, when used in the sense 'politics of' ,are 'the assumptions or principles relating to or inherent in a sphere, theory, or thing, esp. when concerned with power and status in a society' (Oxford Pocket Dictionary 2008). In the context of construction procurement, the assumptions or principles held by agents in the decision making process bring uncertainty to the process because:

- Choice is made by decision makers, who are not necessarily local or even within the country, based on their individual 'mental maps', which are in part historically and culturally determined.
- The knowledge and analytical power of the decision makers are necessarily limited.
- Information is asymmetrically held among the different players involved.
- A society's development path is powerfully conditioned by its past.

For these reasons decision makers use as a reference the institutions that have evolved, essentially, to reduce the uncertainty in human exchanges. Since uncertainty results in large part from imperfect information, the institutions in a society are those that reflect the quality of the information that is available. The greater the uncertainty, the more rigid and limiting the institutional arrangements tend to be, and in the context of construction, the more difficult it becomes to adopt a new and different procurement process that minimizes transactional and enforcement costs. The smaller the uncertainty facing the decision maker, the more flexible the institutional arrangements, and the greater the scope for initiative. Hence, developing countries tend to limit the scope for initiative in public sector contract letting (almost always to the lowest competitive bid) whereas more developed countries experiment with various of the newer formats that even allow negotiation (PPP, PFI, BOOT, BOLT etc).

Improving the level and distribution of knowledge, and thereby reducing the level of uncertainty, is difficult. Consequently, institutional change is not easy for, as North (1990) notes, "…the process of institutional change is largely path dependent. In particular, institutional change starts to occur when the parties to an exchange become aware that to be better off they need to ….restructure the existing rules. However when a path is set on a particular course, the network externalities, the learning process of organizations, and the historically derived subjective models reinforce the course in a path dependent way." Recognition by the stakeholders that change can make them 'better off' is an important part of the battle, understanding the institutions in the country is another, and being able to break away from the restrictions imposed by 'tradition' is probably most important of all.

Decision Making in Trinidad and Tobago (T&T)

T&T became independent in 1962 and became a republic within the Commonwealth in 1976. In the early post-colonial years, the emphasis was on the development of native capacity through institutional reform and training. The early focus was on continuing the excellence of the colonial civil service; this resulted in a very capable public sector in which individuals were not only intellectually developed but also benefited from continuous acquisition of 'know how' through direct experience of both administration and implementation.

The inability of the government to fund its development programme in the 1960's led to it sourcing finance from international agencies. The policies of these IFI's were not ideologically free. They came with the baggage of laissez-faire capitalism reaching back two centuries to Adam Smith and the conviction that market operations maximise economic efficiency. Thus, conditionality for loans was that all major public sector construction contracts (including their design) should be let by internationally competitive tendering. A secondary but still significant aspect of the mind set of the IFIs was that the public sector cannot be as efficient as the private sector. As a result, they were determined that a conditionality of any loan made to a developing country would be that the private sector should be involved (for much on this and related anti-World Bank/IMF commentary see Whirled Bank Group 2003)

Although this shift to the private sector was justified by the IFIs on the grounds of the economic benefits that would accrue, it was also covertly designed to secure work for firms from the developed countries, the large international consulting and contracting firms based there. The consequent flow of funds back to the developed countries from borrowing countries was seen by many to be a primary objective of the IFIs (Perkins, 2005). Feasibility studies were often distorted in order to justify major, expensive projects in developing countries, often committing those countries to perpetual debt for unnecessary (and often environmentally and ecologically harmful) facilities. The enhancement of local capacity in the developing country was not deemed to be a priority, nor was the technical or economic efficiency of the investment, nor the ability of the country to pay off the debt.

The IFI-enforced shift to the design and construction of major infrastructure projects by the private sector led to an exponential reduction in the public sector's in-house capacity and efficiency, caused by the haemorrhaging of trained human capital to the private sector. Very quickly, the public sector found itself unable to develop or attract equivalent expertise. The declining performance of the public sector then became a self-fulfilling justification for out-sourcing to the private sector. This vicious cycle was exacerbated by:

- Public sector organisations being starved of meaningful work.
- The loss of trained personnel at both professional and sub-professional levels in the public sector.
- The use of highly skilled technical staff as managers within Project Execution Units for public sector projects, thus further reducing the technical expertise available
- The loss of 'mentors' for the new, young, and inexperienced professionals recruited by the public service.
- The loss of 'organisational know-how' through staff being used in roles different from their areas of expertise.

The oil bonanza of the 1970's allowed the government of Trinidad and Tobago to accelerate infrastructure delivery, paid for by the windfall. However, the acceleration was not structured; there was little or no planning, no scheduling of the start of projects, only their announcement and initiation. This quickly overstretched the local industry and the government took the unprecedented step of outsourcing the responsibility for procurement to foreign governments through what it termed 'Government-to-Government Arrangements', mainly in Europe. None of these projects were completed on time and within budget. Inflation spiralled, especially in construction. Although no longer constrained by loan conditionalities, the structure of the organisations involved in construction in the country had changed and the institutions followed suit. There were some minor gains in that some new facilities were provided (albeit at enormously inflated prices), and that some local consulting and contracting firms developed capacity, mainly by linking with foreign firms.

From 1985 to 2000, the economy went through a severe depression when financial resources were extremely scarce and construction plans were curtailed. The reduced scale of projects allowed the local private sector to compete with the foreign private sector and it was able largely to meet national demand in terms of infrastructural development. It was also a period when the older institutional arrangements were re-established.

The Present Conditions

The current boom in oil and gas prices has allowed the government to press ahead with a whole range of new public sector construction projects. These have either been allocated through competitive bidding or let through private negotiations with companies, largely from China. Quite apart from concerns over the propriety of the process used for letting these contracts, there has also been concern over the labour, health, and safety practices of these firms that, it is felt, may be substandard and against the 'fair trade' practices enshrined in international conventions and the laws of Trinidad and Tobago. Public expressions of concern led, in 2003, to the Cabinet of the Government of Trinidad and Tobago (GOTT) appointing a committee to make recommendations on the reform of its public procurement system. The committee produced a White Paper that accepted the decentralized nature of the existing system and took the operating principles of Value for Money, Transparency, Accountability, and the Promotion of National Development as its guiding principles. This has not yet been implemented.

In 2008, the GOTT has announced that a commission of inquiry will look into issues relating to the construction industry and the public sector's procurement practices, particularly the use of quasi-private companies to undertake the country's development programme, and to let all public sector projects out of sight, under a shield of private confidentiality. The resulting report is awaited with interest.

Discussion and Conclusions

The human condition is such that knowledge and cognitive capacity is always circumscribed by culture and information partiality. All of these influence the mind-set of a decision maker and the way decisions are made is affected by the institutional rules and regulations that exist. Decision makers have to make choices, choices which, especially in the public sector, will affect the society for generations to come. The finance, for many public sector infrastructure projects, is obtained from IFIs who impose constraints on the borrowers of the money. These restrictions reflect the ideology of the developed countries, which may not be appropriate for the borrower. Once the organisations and institutions of a country are degraded, it is difficult to restore them.

Key Lessons Learned:

- Developing countries have to source funds for infrastructural development from IFIs.
- The IFIs have restrictions that impose their ideology on borrowers.
- The borrowing countries should try to adapt their institutions to allow the flexibility they desire and to protect their organisations from being damaged unnecessarily by competition.

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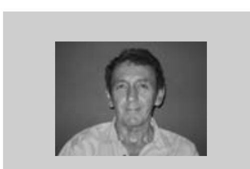

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