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Palestine Economic Policy Research Institute

Corrective Action and Positive Discrimination in Government Tenders

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Main Researcher: Dr. Baker Shtayeh

Supervisor: Dr. Rabeh Morrar

Assistant Researcher: Arwa Aby Hashhash

Research Assistant: Rand Taweel

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Foreword

The Palestine Economic Policy Research Institute (MAS) specializes, *inter alia*, in policies that strengthen micro, small and medium enterprises (MSMEs), gender-responsive interventions and those related to the economic empowerment of youth and the most marginalized groups in society. This study aims to assess the participation of MSMEs in public procurement. It focuses on identifying the most prominent legal and procedural obstacles that limit the ability of these businesses in participating in public procurement. Consequently, it formulates several interventions that are required to give these businesses some preferential advantages in public procurement. The study also suggests methods for enhancing opportunities to participate in public procurement systems and procedures for businesses owned by both genders, as well as those owned and managed by youth, and those owned and managed by persons with disabilities.

The study classifies the reasons for the low participation of MSMEs in public procurement in the West Bank into internal factors and external, legal and regulatory factors. The most significant internal factors are low confidence in procedures for announcing and awarding bids, the difficulty of small-sized contractors to meet classification requirements set by the Contractors Union, the accumulation of tax arrears, the costs of bank and performance guarantees, long periods of time for receiving payment, and complex, contractual dispute settlement procedures. As for external factors, these center on the fact that the public procurement law and system do not contain any explicit texts indicating the possibility of dividing large bids for the purposes of enhancing the ability of MSMEs to participate in them. Additional external factors include delays by procurement authorities in settling the value of public procurement bids, the accumulation of arrears by private sector contractors, the tendency of purchasing government agencies and municipalities to avoid risks in public procurement operations, and delays by the Council of Ministers in mandating procurement authorities to use the unified electronic portal.

The study presents detailed recommendations to enhance the participation of small-sized businesses, especially those owned by women and marginalized groups, in public procurement in Palestine. Most notably, these recommendations cover reforming and developing the quality of public procurement systems and processes, as well as direct interventions by the Supreme Council for Procurement Policies, the Ministry of Finance and procurement entities to amend the articles of the public procurement system where necessary, to allow for positive discrimination in government tenders in favor of the above-mentioned businesses.

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Raja Khalidi
Director General

Executive Summary

Introduction

Public procurement policies play an important role as a stimulant for economic activity in various countries across the world. Their role is not limited to solely serving as a tool for purchasing required goods and services: they are an effective mechanism for reducing poverty, creating job opportunities and promoting economic growth and social development. In the Palestinian context, the process of managing public procurement acquires greater importance, given the limited investment and commercial capacity of the private sector, due to the continuation of occupation and its control over commercial crossings and natural resources. This makes public procurement an important tool in stimulating production and investment.

This study is a continuation of efforts initiated by the World Bank in Palestine to estimate the participation rate of small and medium enterprises (SMEs) in public procurement. Our study will focus on analyzing the environment regulating public procurement operations in the West Bank, while identifying the most prominent legal and procedural obstacles that limit the ability of SMEs to participate in public procurement (the proportion of SMEs did not exceed 8% of the total number bids. In terms of value, their proportion is about 6%). Thus, the study formulates a general conception of the most prominent, legal and procedural reforms that can help to raise the efficiency of public procurement procedures, while formulating interventions that grant SMEs certain preferential advantages in government procurement.

Standards for Classifying and Defining Establishments in terms of Size (small, medium or large)

The classification of establishments into small, medium and large depends on numerous considerations. In the Palestinian case, we find that most studies have adopted the criterion of the number of workers in classifying establishments, which is attributable to the weak data on establishments in terms of their sales' volume. Accordingly, in its definition of SMEs, this study utilizes the old classification of the Ministry of National Economy, using the criterion of the number of workers: that is, establishments that employ less than 20 workers. There are two reasons for this choice:

1. Such establishments are considered less qualified and less capable in terms of engaging with the public procurement (bidding) system. Enterprises that employ 20-49 workers, with annual sales of up to \$2,000,000 (these are considered medium-sized enterprises according to the new definition of the Ministry of National Economy) are considered to be organized and stable enterprises. They account for more than 30% of the total number of government tenders, and 19% of the value of such tenders during 2017-19. However, they constituted only 1.17% of total establishments operating in the West Bank.
2. The study's data and statistics on public procurement are taken from the period 2017-19. That is, the period before the adoption of the new definition by the Ministry of National Economy.

Obstacles to the Participation of SMEs in Public Procurement

The study concludes with the identification of a set of obstacles that limit the ability of SMEs to participate in public procurement. Among these obstacles are:

1. The low confidence of SME owners in general, concerning the government's procedures for announcing and awarding bids.
2. The low degree of technical capabilities at many small establishments.
3. The accumulation of tax arrears at some small companies, and consequently their unwillingness to enter into public tenders in order to avoid tax settlement.
4. High fixed, administrative costs (not related to the costs of producing goods or services). This includes bank guarantees, performance bonds, registration requirements for suppliers and contractors, documentary requirements and procedures, qualification requirements, long-term payment periods and complex, contractual, dispute settlement procedures.

The study also details certain, external obstacles that can be combined with policies to reform and develop the quality of public procurement systems and procedures (indirect interventions). These aim to enhance the confidence of targeted bidders in systems and procedures, based on the application of global best practices for the integration of SMEs in public procurement.

Policies to Reform and Develop the Quality of Public Procurement Systems and Processes (Indirect Interventions)

Proposed policies are preceded by outlining strengths in the quality of public procurement systems and procedures, which have much progressed. These are used as building blocks, as a legal and procedural entry point to increasing the participation of SMEs in the public procurement system.

Complementary policies to reform and further develop the quality and transparency of public procurement systems and processes (indirect interventions) can be summarized in the following points:

1. The biggest problem for small companies was the delay in paying the value of purchases by contracting entities, noting that total value of SME procurement contracts amounted to 6% of the total value of signed contracts, i.e. no more than \$45 million annually. If the target is to double the share of SMEs in public procurement, then total government commitments to SMEs will not exceed \$90 million. It should be noted that the field survey indicated that a large number of SMEs who do not participate in government procurement would be ready to apply for participation, in the event that the government committed to a payment of the value of the contract upon delivery (one third of the total amount, for example), while scheduling the remainder as payments over one or two years from the date of delivery.
2. Complete the inclusion of all governmental centers and local authorities into the unified electronic portal of the Supreme Council for Public Procurement Policies, while mandating them to announce invitations to submit bids, prequalification requests, or expressions of interest, through the web-based portal.

3. Complete the plan of the Supreme Council for Public Procurement Policies that seeks to target all companies (including SMEs), such that they register directly on the portal's databases via an electronic form, while taking into account the following:
 - a. Enabling procurement entities to register companies on a permanent list of qualified bidders. This works to enhance the possibility of these companies participating in procurement by governmental centers.
 - b. Developing the electronic form prepared for registering companies through the portal, such that classification fields required for data analysis are mandatory (field of specialization, number of employees, sales volume, company capital, etc.).
4. Inform all companies on the existence of the Dispute Review Unit (affiliated with the Supreme Council for Public Procurement Policies) and its functions, through the media, social networking sites and representative bodies, in order to enhance the confidence of SMEs in the integrity and transparency of public procurement procedures.
5. Provide administrative, procedural and technical support to workers at SMEs in the fields of bidding, public procurement procedures, and financial/technical qualification requirements, utilizing human resources at the Supreme Council for Public Procurement Policies and partner representatives from unions and federations.
6. Follow-up on the Cabinet's decision regarding the granting of "preferential treatment" to cooperative societies in public procurement contracts, through:
 - a. Defining the term "preferential treatment" by the Ministry of Finance and the Supreme Council for Public Procurement Policies.
 - b. Specifying the procedures to achieve this preferential treatment, while also following-up on the extent of compliance with it.
7. Address the issue of dissatisfaction with the provisions of the procurement law and systems that allow procurement authorities to divide tenders, without any indication of whether the division has been performed for the purposes of increasing the ability of SMEs to participate in the tendering process. When and where possible, new articles ought to be added to the procurement system that gives the procurement agent the ability to utilize tendering methods for large bids by dividing them, should such a division enhance the ability of targeted SMEs to participate in public procurement contracts (unless this leads to a significant increase in the cost of public procurement).
8. Analyze the economic sectors and activities associated with public procurement, and the extent to which each activity benefits from economies of scale. This is in order to identify the activities that benefit the least from such economies of scale (in other words, those that will benefit the most from adopting divided tender policies), and those that benefit the most (causing an increase in the cost of public procurement, in the event that tenders are divided).

Direct Interventions and Positive Discrimination Policies

It must be pointed out that both official and union bodies engaged in regulating public procurement (the Supreme Council for Public Procurement Policies, the Ministry of Finance, the Contractors Union and PITA - Palestinian Information Technology Association of Companies) do not favor direct, positive discrimination. Their view is that in most cases, positive discrimination conflicts with the principles of free competition, overriding the

principle of “value for money” and resulting in high public procurement costs incurred by large companies and official, procurement centers. These official and union bodies are satisfied with the principle that there are no legal obstacles facing SMEs in participating in public procurement.

Based on a review of the experiences of other countries, combined with a field survey targeting a sample of SME owners, public bodies and unions (as outlined above), it can be argued that future interventions should be based on the development of a five-year plan which aims to double the share of SMEs (or those that employ less than 20 workers) in the value of public procurement contracts, from 6% to 12%, eventually planning to reach 20%. This is the internationally accepted percentage according to global experiences. Proposed interventions that promote direct, positive discrimination for the benefit of such companies can be summarized as follows:

1. Targeting SMEs in strategic sectors and activities (according to the Palestinian national strategy) that have the highest labor intensity and/or the largest, national component with price discrimination policies in tender contracts, at a rate equal to the percentage granted in government tenders for national products (15%).
2. Granting additional qualification points in large bids (especially in the field of contracting) for contractors that sign agreements with SMEs. Qualification points are linked to the value of subcontracts as a percentage of total contract value.
3. Allocating half the value of direct purchases (without the “\$3,000 for supplies or \$5,000 for works” stipulation), and at least half of the tender value for purchases below \$20,000 (non-consulting supplies, works and services) for competition between SMEs that meet the required qualification criteria. In this way, the allocation of tenders is based on purchases related to strategic activities (see No. 1).

It should be noted that public procurement contracts below \$20,000 constitute 52% of all public procurement contracts. However, their percentage in the value of bids is low (0.5% of the bid value goes to direct purchase). Therefore, the marginal impact of this intervention on large companies remains limited. In addition, these purchases are more proportional to their costs from the perspective of SME scale economies relative to large companies.

4. Dedicating a page on the electronic portal for public procurement that displays SME products and services to procurement entities and relevant authorities, for the purposes of promotion and networking.

Case study: I.T. companies in the West Bank

This part of the study deals with an analysis of the activities of the I.T. sector as they directly relate to public procurement, in order to develop a proposal for direct and indirect interventions to serve all parties involved in public procurement. Concerning information and communications technology, this study covered both software and hardware purchases made by government agencies, municipalities and village councils through public procurement contracts. The study deals with justifications for targeting the I.T. sector, despite its limited contribution to government procurement.

This section concludes with a vision for the general features of this sector within the public procurement structure, where the most prominent are:

1. The absence of detailed, central databases on the public procurement of IT goods and services, according to company or the type of the procurement process, whether at the Ministry of Finance, the Supreme Council for Public Procurement Policies, or the Palestinian Information Technology Association of Companies (PITA). Therefore, data obtained about the public procurement of these products are estimates made by the research team through interviews conducted with PITA and some large companies involved in public procurement.
2. The annual volume for the public procurement of software products is estimated at about USD 20 million, with USD 8-10 million for products and the maintenance of computer hardware and accessories.
3. According to PCBS data, the number of establishments working in the field of software is 110, while establishments operating in the field of computer hardware and accessories number 3,140 (including registered companies and unlicensed establishments). The number of enterprises affiliated with PITA that participate in government tenders for software is estimated at 5-8 companies. Those that participate in government tenders in the field of computer hardware and accessories number 12-15 companies.
4. SMEs operating in the field of software in Palestine that participate in government tenders see a great opportunity to expand their expertise and build the skills of their employees. Moreover, SMEs that are not PITA members have better prospects for participating in public procurement if their line of business is focused on software and not on hardware, given the absence of hardware supply costs.
5. Within this context, the problem lies in the inability of many small, software companies to deliver according to the specifications and schedules outlined in public procurement contracts, given complex technical requirements for some purchases. This may not be commensurate with the qualifications of these small companies, which confirms the importance of creating a regulatory framework for licensing and categorizing IT companies.
6. Public tenders and framework agreements are limited to specific companies, with a very limited margin for rotation between them. All companies that won government tenders are more than ten years old, which means that the possibility of participation for new or existing small companies is weak.
7. The desire of small and medium IT companies to participate in public procurement increases if the procurement agent is a municipality, local council or donor.
8. Despite efforts made by PITA to localize the public procurement market for software products, some procurement centers still request certain software solutions from foreign companies, or disregard the purchase of such solutions from foreign companies. This is especially true in light of the specifications of some government tenders for procurement funded by donors, where they are typically obliged to adhere to donors' standards and specifications that are only compatible with solutions sourced from foreign companies.

Reasons for the Weak Participation of I.T. SMEs in Public Procurement

1. The low confidence of bidders in the technical descriptions, award processes, control mechanisms and procedures to receive goods.
2. Irregular government payments for procurement contracts.
3. Public procurement specifies acquisitions from authorized agents and distributors only for devices and accessories (either directly or through commercial partners), in order to ensure easy access to after-sales services, spare parts, maintenance and development.

Proposals to Enhance the Participation of SMEs in the I.T. sector in Public Procurement

1. Reforming public procurement systems and procedures that directly relate to enhancing the confidence of bidders in groups targeted by these procedures. These reforms include:
 - a. Enhancing transparency in bidding and award procedures. It should be noted here that control over the procurement operations of purchasing centers are performed remotely (off-site). That is, control is performed after the completion of the purchasing process, and not during design or implementation. This is the case with the Ministry of Finance's oversight via the General Administration of Civil Financial Control; the Office of Financial and Administrative Oversight; and internal control units at procurement centers. The design of procedures for public procurement is also limited, with decisions made by the Supplies and Procurement Manager and Finance Manager solely.
 - b. The field survey of bidders clearly indicated that there is a state of mistrust in public procurement procedures among SME owners, particularly concerning technical specifications and delivery procedures specified by public tender committees. Specifically, this concerns the issue of accepting lower specifications than advertised (upon receipt), a process that requires more transparency. The solution at this point may be to allow the bidders who come closest to matching requirements to win the contract, and to attend meetings on specifications and delivery procedures. This may enhance the confidence of the target groups in applied procedures.
 - c. Up-skilling committees concerned with preparing the estimated cost of purchasing operations at some procurement centers.
2. Dividing centralized bids for hardware and accessories at the level of directorates, especially at the ministries of health and education. The objective of this segmentation is to:
 - a. Geographical impartiality in the award of tender contracts across all governorates.
 - b. Reducing bidders' movement and transportation costs.
 - c. Compatibility of the retail process with the goal of integrating SMEs.
3. Dividing tenders for hardware and accessories into two parts: one for the supply of hardware, and a second for maintenance. This enhances the competitive prospects of other companies (those that are not authorized agents/dealers).
4. Forming a joint committee between the Ministry of Communications and Information Technology, the Ministry of National Economy and PITA, such that standards and conditions are set for licensing and registering all establishments operating in this field, as well as determining the appropriate licensing fees commensurate with the size of the company, as detailed below:
 - a. The number of employees in the company.

- b. The company's capital.
 - c. Estimated sales volume.
 - d. Technical specifications.
 - e. Management specifications.
 - f. Financial and supervisory specifications.
5. The application of the Global Industrial Classification Standard (GICS) for the organization of IT activities, dividing products into three groups:
- a. The first group: computer equipment and its accessories. This is divided into three sub-groups, namely: communications' equipment; technical devices and peripheral equipment; electronic equipment, components and tools.
 - b. The second group: the software group. This is divided into two subgroups: the I.T. services' group and the software group.
 - c. The third group: semiconductors group.
6. The process of organization and classification allows the division of procurement operations into categories commensurate with the qualification requirements governing the classification process, such that a percentage of public procurement operations are allocated to competition between qualified SMEs, without allowing large companies to compete. This mostly concerns direct procurement and solicitations.

It should be noted here that I.T. tenders funded by international organizations are made according to a classification set by these organizations, to which procurement centers must commit too, while adhering to the principle of "the cheapest and most matching" in the Ministry of Finance's bids.

7. Adhering to a regular mechanism for the payment of dues to SME bidders (a down payment followed by regular, monthly installments), taking into account the allocation of a larger down payment to bidders in the field of hardware and accessories, because they bear higher supply costs relative to software companies.