Transparency and Openness of Public Procurement Market – Case of the Czech and Slovak Republic

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Abstract

Public procurement is a very important instrument used for allocation of a major part of public expenditures. Because of its importance, guarantees of a transparent, open and professional system of public procurement should exist in every country. However, the reality in the CEE countries is different. A number of purchases are not open and therefore funding allocation is not transparent and possibly also not effective.

Over the last years, the size of the public procurement market in the CEE transition economies has increased. As of today, we estimate that public procurement in CEE represents more than 10 % of GDP (in case of the Czech Republic even 17 % of GDP).

At first, we discuss the concept of effectiveness and efficiency in the public procurement including the differences between these two conceptions. We analyse the importance of transparency and openness of public procurement and their impact to the effectiveness as well.

The second part of our paper describes the development of the public procurement law in the Czech and Slovak Republics during the period of 2001-2005. We try to identify how the changes in the law could have affected the transparency and openness of public tenders and if there exist legal ways of contract allocation without any public tender.

In the third part we develop three indicators in order to measure the transparency and openness of the public procurement market. The first indicator describes how many percent of the overall public procurement market is allocated through open tenders. The second indicator shows how many percent of the overall public procurement expenditures are allocated through so-called “small” contracts, i.e. contracts which are not directly specified by the law and which have a character of a “free hand” choice. The last indicator deals with international transparency and shows how many percent of the overall public procurement expenditures are advertised in the EC Journal.

Within the fourth part we calculate the previously defined indicators for the Czech and Slovak Republics for the period 2001-2005. Preliminary results indicate that the situation in the sphere of openness as well as of transparency is not good. Through open contracts is allocated only one third of the overall volume of public procurement expenditures. Much more frequent are “small” contracts. We can also find significant differences between the Czech and Slovak Republics. This is a result of different national laws.

The last part provides synthetic conclusions. We analyse the main reasons for the low degree of openness and transparency in the procurement systems of the Czech and Slovak Republics and suggest several measures of how to improve them.

Key Words: Czech and Slovak Republics; Effectiveness; Openness, Public Expenditures; Public Procurement; Transparency

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I. Introduction

Public procurement is a very important instrument used for allocation of a major part of public expenditures. Because of its importance, guarantees of a transparent, open and professional system of public procurement should exist in every country. However, the reality in the CEE countries is different.

According to us a good public procurement is only the one, which is not corrupt and at the same time it is efficient and effective. We will try to explain the above terms and relationships between them in the first part of our paper. The second part introduces our concept of measurement of the transparency and openness of public procurement market and shows the results of our calculation.

II. Discussion of the Key Terms in the Context of Public Procurement

Effectiveness of the public sector, in a broader sense, is the result of the relation between the volume of inputs to the public sector and the volume of outputs from the public sector. For example Peková (2002) regards the effectiveness as a situation, when the maximum benefit is gained from the available social resources. However, it is not easy to measure the effectiveness of the public sector or, concretely, the effectiveness of the public procurement. It is so because the inputs to the public sector can be quantified, however it is often difficult to quantify the benefits gained by the citizens from the production of the public sector. Economists try to measure the effectiveness and the basis of many economic analyses is constituted by comparison of the costs and effects of alternative solutions. They focus on identifying, measuring, estimating and comparing the costs and effects of various alternatives whose implementation is considered. They work with the so-called quantifiable indicators, indicators of effectiveness, which relate to the effects of various projects from the viewpoint of the expected outputs, results and benefits. Monitoring of the above parameters is carried out also by means of the so-called benchmarking – i.e. comparison of the price and the quantity of the selected goods and services purchased by the monitored organization.

Apart from the term effectiveness, there is also used the term efficiency. However, in many professional texts, these terms are not clearly defined and differentiated. It is pointed out for example by Prušvic (2004). Both words are usually used together without obvious specification for example in documents of the World Bank or OECD. In their reports, parts evaluating public procurement only state whether it is or is not „efficient and effective“, or that a country has troubles securing „effectiveness and efficiency of the public procurement.“ OECD publication „Harmonising Donor Practices for Effective Aid Delivery. Strengthening Procurement Capacities in Developing Countries“ does not define neither of the terms even though authors estimate percentual and absolute values of possible improvement of effects of foreign aid in case of improvement of efficiency and effectiveness of public procurement in recipient countries. Readers are only implicitly informed that if public procurement in recipient countries would meet higher quality standards, „more efficiency“, „more efficient use of public funds“ and „greater value for money“ would be among resulting benefits.

More precise definition is in the paper „Releasing resources to the front line. Independent Review of Public Sector Efficiency“ prepared for the British government in 2004 with ambition to identify possible cost economies in public administration. In this paper, efficiency „involves making best use of the resources available for the provision of public services.“ Effectiveness is touched only implicitly when author declares that focus on economies should not affect service quality and accessibility in a negative way. The paper mentions two positive examples related to public procurement. First, establishment of the Office of Government Commerce mission of which is to provide governmental institutions with consulting services concerning public procurement and, in case such need arises, to help them negotiate better conditions. The Office was often able to cut costs of procurement by merging several bids into one, thus purchasing larger quantity and negotiating lower price, and cutting administrative costs of procurement process. The second example is National Healthcare System, which
implemented electronic procurement process. This way NHS saved large sums of money on administrative costs and postage.

Direct reaction is presented in the paper „Sustainable Procurement and Procurement Efficiency Implementation” presented by the Office of Government Commerce. This paper focuses on effectiveness, claiming that efficiency does not necessarily mean the lowest possible price. Other conditions also have to be met to make public procurement sustainable, like EU procurement rules, or „Value for Money policy of the British government. Value for Money policy binds procuring authorities to consider – apart from efficiency and price of purchased goods – quality, whole life costs\(^2\), innovation, competition and opportunities for small and middle enterprises. The Office states that compliance with these rules will make savings sustainable in the long run.

Another important term in the context of the public procurement is efficacy. For the purposes of our study, we will regard an efficacious public procurement as the power to produce a desired effect\(^3\). It means that in the case of an efficacious public procurement, at the end of the public procurement we will achieve the effect which we wished to achieve. If the aim is to buy a computer, then an efficacious public procurement is the one, at which we succeed to buy the computer, which we originally planned to buy. The effectiveness is reflected in the price paid for such computer. And an efficient public procurement is the one when the computer which we wanted costs the least possible.

We will also touch on some other conditions of a good public procurement: the openness and transparency. These are the tools which support control of the public procurement by the public, and thus they possibly decrease possibilities for corruption activities. We regard the openness as a possibility of individual stakeholders to participate in the public procurement process (for example possibility of particular business to submit the bid). Or in Slovakia, there used to exist a possibility regulated by law to monitor certain stages of the public procurement process by non-governmental organizations. Another example is a possibility of bidders to personally attend the opening of the envelopes. Transparency means both active and passive publishing of information. We regard the passive publishing of information as provision of information by purchasers upon request made under the Freedom of Information Act. An active publishing of information occurs when the proper purchaser publishes selected information, whether in an official journal, own websites or official announcements.

We assume that the higher is the transparency and openness, the better preconditions there are for a good procurement, competition in bidding and thus also for a better proportion between the price and quality and, in the end, also for the effectiveness.

### III. Development of the Public Procurement Legislation in the Czech Republic and Slovakia between 2001 and 2005

#### III.1. Czech Republic

For a relatively long time, the domain of the CR’s public procurement market had been governed by a legal norm that was different from the concept prevailing within the European Union. Until 1 May 2004, the regime of public procurement in the Czech Republic had been regulated by the Act No. 199/1994 Coll. „On Administration of Public Procurement“ which has been during its lifespan amended in total twelve times. In a number of cases were behind the numerous amendments criticism by the European Union and the effort to increase the degree of transparency in this area. Public procurement has been considered by this Act as a paid

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\(^2\) In a different document of the British government value for money is defined as „...the optimum combination of whole life cost and quality (or fitness for purpose) to meet the customer’s requirements. This definition enables a public body to compile a procurement specification which includes social, economic and environmental policy objectives within the procurement process. “Whole life cost” includes both quantifiable and non-quantifiable or intangible costs and benefits. “

\(^3\) The New Webster’s..., 1992.
contract concluded between the contracting entity and the selected contractor for supplies, services or (e.g. construction) works, if concluded by any of the contracting entities specified by the Act. These entities were in their procurement procedures obliged to follow the Act. The difference against the EU legislation was possible to see mainly in the awarding methods. The main method of awarding procedure was a public commercial tender, an open tender for provision of goods and services. In case of an extensive, complicated and technically demanding public procurement or a procurement which form was not known beforehand and needed to be designed during execution of the delivery, it was possible to use a modification of this method – two-stage public tender. Within the first round, which was completely open, was assessed the capability of individual applicants to carry out the contract from the perspective of the demonstrated applicant’s technical capacities, qualifications, etc. The price did not represent basis for an evaluation at this stage; in fact, offers in the first round were not allowed to include any reference to their monetary value. During the first stage were eliminated applicants who did not comply with the stipulated requirements. The remaining (at least three) contestants were invited to participate in the second round, which had a character of a closed public tender.

Apart from the commercial public tender, contracting entities were allowed to use four additional alternative awarding methods:

1) **Invitation of a number of applicants** with a character of a restricted procedure. The call for bids had to be addressed to at least five contractors and could had been used in specified cases only where the monetary value of the future commitment excluding value-added tax exceeded CZK 5 million in case of a real-estate property and a machinery forming single functional unit. In other cases, the threshold monetary value was set at CZK 2.5 million. Conditions for the use of this method were: state of urgent necessity declared by the government, specialised procurement, and presence of classified information.

2) **Simplified awarding procedure** related to contracts with monetary value exceeding CZK 2 million and not exceeding the limits specified in the (above mentioned) case of the invitation of a number of applicants. Again, this was a limited public tender under which an invitation must had been sent to at least three applicants.

3) **Public procurement of a minor scale** was procurement with monetary value not exceeding CZK 2 million. In this case, the contract could have been awarded directly for the price customary at the place of fulfilment.

4) **Invitation of an individual applicant for a submission of an offer** had a character of an individual negotiation. It could had been used only in legally specified cases, the key ones being:

   - Urgent need associated with a life- or health-threatening situation or potential large-scale material damages;
   - Liquidation of natural disaster consequences;
   - Specialised public procurement that only a specific contractor could provide;
   - Additional or repeated public procurement which volume did not exceed 20 % of the volume of the original procurement.

Due to the fact that even after amendments, the Act No. 199/1994 Coll. was not in line with the EU legislation, it was necessary to carry out its replacement with a completely new piece of act. Such a new legal norm became the **Act No. 40/2004 Coll. „On Public Procurement“** which put in harmony the legislation of the Czech Republic with the regulation of the European Union. Within the new Act, introduced were the classical division of public tenders according to the subject of fulfilment into contracts on construction services, supplies, and services, and according to their volume on the above-the-threshold, below-the-threshold, and minor public contracts.
In case of the above-the-threshold procurement, the new Act fully followed the EU rules. Awarding of the below-the-threshold contracts has been mildly modified, notably e.g. in the case of a preferential treatment of domestic firms employing, on the re-calculated basis, more than 50% of employees with reduced work ability (disabled).

Both types of public tenders could be awarded via four classical types of administration, i.e. open procedure, restricted procedure, negotiated procedure with publication and negotiated procedure without publication.

The main changes in the sphere of public procurement awarding which the Act No. 40/2004 Coll. brought were the boost of transparency and lowered possibility of foreign subjects’ discrimination. Particularly in case of the above-the-threshold contracts was a high degree of transparency guaranteed owing to the obligation of their publication in the EC Journal. In case of the restricted procedures, significant reduction of cases under which this method is allowed had also taken place.

From the perspective of the selection of awarding procedures, the new Act represented a shift from the so-called scope-contracts, which allowed the state and its public sector organisations, respectively, to negotiate long-term contracts with suppliers holding in their respective segments positions of either a directly monopoly, or that of a very significant player. Another new type of institute was the public tender on design, which covered procurement whose specifications are not given in advance.

With respect to the practical adoption of the Act No. 40/2004 Coll., however, within a year of its effectiveness several problematic areas become apparent whose issues were not possible to overcome by methodological explanation. Among these problematic areas ranked mainly:

- opaque definition of certain types of contracting entities;
- specification of proceedings within individual types of awarding procedures, especially in terms of administrative procedures;
- excessive rigidity of awarding procedures in case of below-the-threshold procurement;
- gaps in legal treatment of objections and concurrence of deadlines;
- ambiguity in establishment of qualifications (certificate of fulfilment of national qualification and classification system criteria for construction contractors);

Therefore, agreement has been reached on designing a new act, approved in spring 2006 under the No. 137/2006. Coll. On the system level, the new Act does not change basic institutional parameters of the public procurement market. From the most important changes it is possible to mention increase of the monetary volume limit for minor construction procurement from CZK 2 million to CZK 6 million and broadening of the scope for application of electronic auctions.

### III.2. Slovak Republic

The Public Procurement Act (PPA) was drafted in Slovakia, as in the first post-communist country, in a simple form based on the recommended UNESCO Model Law in 1993.

In 1999, it was amended, while taking into account the contents and terminology of the EU regulations on the public procurement. It was in compliance with general principles of the public procurement; it established a Public Procurement Office (PPO), introduced the requirement of professional qualification for the public procurement and extended the scope of the institute of supervision and objections. As for the viewpoint of transparency of the public procurement, the Act’s provisions included the principle of transparency, there was secured publishing of notices of announcement and results of public procurement prescribed by law in the case of competitive methods in the public procurement Bulletin and there was introduced an institute of a register of eligible entrepreneurs. With the aim to increase transparency of the procurement process there was allowed, upon proposal of Transparency International Slovakia - TIS, appointment of other members of the committee for
assessment of bids, who were not entitled to assess the bids and there was introduced an obligation to observe the public procurement principles also in the case of the above-the-threshold contracts.

Slovakia entered the third millennium with a comprehensive legislation on the public procurement and system of its enforcement, which was also supported by the requirement to improve the professional qualification. In practice, there was experienced evasion of PPA and abuse of the non-competitive direct order (negotiated procedure without publication); control activities were often limited to formal determination of administrative shortcomings in the Act’s application and despite a broad foreign assistance and a successful pilot program of a joint procurement announced by the Government (of several public purchasers based on a framework agreement), assertion of a rationale joint procurement in the legislation was not successful. Under these circumstances, there were adopted two amendments on the public procurement, which were in fact not conceptual (each time they were justified by the need to comply with the EU regulations on the public procurement).

From the viewpoint of increasing the transparency and anti-corruption activities in the public procurement the Act’s Amendment No. 557/2001 Coll. introduced (apart from an administrative change of its effect also to self-governing regions and extension of the above-limit procurement methods) an obligation to allow the bidders’ participation in opening of envelopes with bids and their right to receive minutes from the opening, an obligation to make a market research in the case of a direct order (negotiated procedure without publication), publishing of a list of entrepreneurs deleted from the register of eligible entrepreneurs and the obligation of supervisors and controllers to assess correctness and success of the procurement, above all with regard to the achieved result, while procedures prescribed by law must be observed. Objections to the purchaser’s procedure are no longer decided upon by PPO clerks, but by the appointed senates.

The Act’s Amendment No. 530/2002 more extensively adopted formulations from the EU regulations (based on the pressure of the European Commission, however unfortunately these EU regulations were being repealed at that time) concerning a purchaser representing a public authority or a natural monopoly, preconditions for participation in the public procurement (personal status, financial and economic status and technical eligibility) and samples of notices. As for increasing transparency and anti-corruption activities, there was allowed publishing of notices in the professional press, after their publishing in the public procurement Bulletin (not on the Internet yet). Notices of results of direct orders (negotiated procedure without publication) can also be published in the public procurement Bulletin; previously unappealable decisions of PPO are reviewable by court; there was allowed reviewing of bids with unusually low price and prohibited the criterion of the guarantee period in assessment of bids.

Between 2003 and 2005, TIS\(^4\) carried out an extensive monitoring of the public procurement in five rounds according to a uniform methodology, while each round was carried out in comparable organizations from all Slovak self-governing regions. Hundreds pieces of information concerning 77 monitored organizations were gathered based on the Freedom of Information Act and from the information publicly provided by PPO. Regional towns and some district towns, district hospitals, offices of higher territorial units and subordinated secondary schools (high schools and secondary vocational schools), ministries and waterworks companies were monitored in individual rounds. Results from each round were independently assessed and publicly presented. Out of many overall conclusions from all rounds we can mention, as the most important from the viewpoint of the procurement’s transparency and anti-corruption activities, evasion of PPA in purchases, lack of interconnection between the budget and the public procurement, problems with publishing information on the public procurement and lack of use of websites, insufficient use of simple electronic information technologies and low interest to apply codes of procurement ethics and integrity pacts which are not regulated by law. Non-competitive direct order is used very often (46 % of all procurement cases) to the detriment of the recommended competitive methods (although the situation in the monitored organizations is better than the national average),

\(^4\) For more information see Vlach – Stičáková-Beblavá (2004).
joint procurement is hardly used, there are objections against completeness and comprehensibility of tender instructions and minutes of bid assessment, there is a disproportionately high number of objections to the purchasers’ procedures and a benchmark comparison of the prices reached by the public procurement and the prices on the open market demonstrates the lack of use of high quantity discounts.

The above experience was also used in drafting of a new Public Procurement Act No. 25/2006 Coll., which has been effective from the beginning of 2006. This Act was already fully adapted to the new EU regulations on the public procurement of 2004 in the area of the above-limit procurement (unfortunately also in the area of the below-limit procurement). There were also introduced stricter conditions for the use of non-competitive direct order, there was allowed joint procurement of several purchasers, there were allowed activities of registered public procurement agencies, there was introduced a deposit for filing of an objection to the purchaser’s procedure, which is forfeited if the objection shows to be unjustified and there was imposed an obligation on PPO (not only a possibility anymore) to impose the specified fines for the failure to observe provisions of law.

IV. Indicators of Transparency and Openness and their Definitions

With the aim to measure the degree of transparency and openness of public procurement markets, three indicators have been constructed. The first one is an “Index of Transparency of the Public Procurement Market (I1)”. The value of this indicator states how many percents of the resources outlaid within the institute of public procurement in a given calendar year were awarded in an open procedure.5 The index can be specified as follows:

\[
I_1 = \frac{\text{Volume of public procurement awarded in open procedures}}{\text{Total volume of the public procurement market}} \times 100
\]

The second indicator is an “Index of Non-Transparent Procurement (I2)”. Its value states how many percents of resources outlaid within the institute of public procurement in a given calendar year were allocated within the regime of so-called minor procurement and outside of the jurisdiction of the Act on Public Procurement. The second case (i.e. procurement outside of the jurisdiction of the Act) represents military procurement which, due to security reasons, cannot be awarded in an open procedure. The indicator can be specified as follows:

\[
I_2 = \frac{\text{Volume of public procurement awarded in all types of allocating procedures specified by the Act except for minor procurement}}{\text{Total volume of the public procurement market}} \times 100
\]

Finally, the third indicator is an “Index of International Openness (I3)”. The value of this index states how many percents of the public procurement market are awarded in the form of above-the-threshold procurement required by the law to be advertised in the EC Journal. The value of a similar index has in case of old EU member states ranged around 28.8 % in 2004. The index can be specified as follows:

\[
I_3 = \frac{\text{Volume of above-the-threshold public procurement}}{\text{Total volume of the public procurement market}} \times 100
\]

The main data source for the calculation of the above-mentioned indicators were the Information System of Public Procurement (or Central Address, respectively) in the case of the Czech Republic and, in the case of Slovakia, data provided by the Office for Public Procurement Office. From these sources were determined the volumes of public procurement allocated via individual

5 Before May 2004, when the Act No. 40/2004 Coll. became effective in the Czech Republic, public commercial tender was considered as an equivalent to an open procedure.
types of awarding procedures. For the calculation of the total volume of the public procurement market, modified OECD (2001) methodology has been used. The analysis did not include data related to health insurance companies and sector contracting entities.

V. Results of the Calculations

Based on the above-mentioned methodology, calculations of the specified indexes were performed for the Czech Republic in 2001-2005 and Slovakia in 2004-2005. The results are summarised in the following tables:

| Table 1: Indicators of the public procurement market in the CR in 2001-2005, figures in % |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|
|                                 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Index of Transparency of the Public Procurement Market | 27   | 35   | 29   | 19   | 27   |
| Index of Non-Transparent Procurement | 71   | 63   | 69   | 77   | 58   |
| Index of International Openness | -    | -    | -    | -    | 21   |

Source: own calculations

| Table 2: Indicators of the public procurement market in Slovakia in 2004-2005, figures in % |
|---------------------------------|----------------|----------------|
|                                 | 2004 | 2005 |
| Index of Transparency of the Public Procurement Market | 21   | 38   |
| Index of Non-Transparent Procurement | 64   | 33   |
| Index of International Openness | 12   | 33   |

Source: own calculations

From the presented data are evident considerable differences between the two countries in the allocation structure of public sector expenditures within the public procurement market. The market transparency is in the case of the Czech Republic significantly lower than that in Slovakia. This fact is reflected in the relatively low value of the Index of Transparency of the Public Procurement Market in the Czech Republic as well as in the considerably high value of CR’s Index of Non-Transparent Procurement. The second case is particularly alarming, as it indicates that majority of the resources outlaid by the public sector for purchases of goods and services were awarded in the regime of minor procurement where no procedural requirements are specified and legally binding. Most of these cases are related to awarding from free hand, which possesses absolutely no attributes of a competitive process and, as a consequence, decreases the probability of receiving the best possible price. The values of the Index of Non-Transparent Procurement also show that the Act on Public Procurement influences only smaller share of the market with public procurement.

The large differences between the two countries are to a considerable degree a product of different legislations. This is particularly the case of minor procurement, where the key role represents the upper monetary limit of individual procurement. The long-standing value of the limit – CZK 2 million – clearly appears to be excessive. The situation in Slovakia, however, is not that “rosy” as the presented data may suggest. The reason rests in the fact that even certain standard awarding methods, specified by the Act on Public Procurement, are not very transparent. This is in particular the case of negotiated procedure without publication, which possess de facto a character of a free hand awarding. This institute, in the Czech Republic used only minimally, enjoys considerable popularity in Slovakia. In 2004, SKK 15 billion were awarded by this method and in 2005 already almost SKK 26 billion. If we reflect these data in the calculations and add them to the total volume of resources awarded outside of the regime of the Act (minor and classified procurement), the Index of Non-Transparent Procurement rises to 76.5 % in 2004 and to 56.5 % in 2005, respectively. These values are subsequently fully comparable with those measured in case of the Czech Republic.

The values of the calculated indicators point towards a higher degree of transparency of public procurement market in Slovakia compared to the Czech Republic. However, because the data are available only for 2004 and...
2005, it is not possible to draw any conclusions with respect to the existence of a long-term trend or just a short-term deviation. In general, it seems as an advantage to set a lower value for the upper monetary limit for minor public procurement, thus significantly lowering the volume of resources allocated outside of the jurisdiction of the Act on Public Procurement. On the other hand, in case of Slovakia it is necessary to point at the fact that considerable proportion of the resources is outlaid within awarding procedures without publication, including a number of above-the-threshold procurement. This type of awarding procedure is less transparent than other and the question remains whether in all cases of its application are satisfied the conditions specified for its use by the Act in the given years.

Based on the conducted analysis, it is possible to establish that institutional settings have an impact on the operation of the public procurement market. As an example may serve the relatively radical change of the Czech legislation in 2004 which resulted, following certain „transformational“ decrease in transparency, in a decrease of the importance of minor procurement. On the other hand, however, the system under weak functioning of informal institutions has a tendency towards getting around legal norms, as can be demonstrated by the case of Slovakia and the shift of a considerable volume of resources from minor procurement towards contracts awarded via procedures without publication. In general, therefore, it may be concluded that the prospective reform effort should not be directed towards creation of still new and better legal norms, but rather to emphasise the compliance with the existing laws and their appropriate implementation. The main reforming effort of the Czech Republic and Slovakia should with this respect concentrate notably on the system of below-the-threshold procurement, which is fully in competence of the national parliaments. Within those changes, the following measures should in particular take place:

- reassessment of the upper monetary limit for the use of the minor procurement scheme;
- improvement of the control mechanisms in case of minor procurement;
- implementation of the requirement of contracting entities to secure at least three bids in case of minor procurement;
- increase the volume of procurement allocated via open tenders; and
- pursue a more active approach towards elimination of situations when procurement are broken-down into smaller parts.

Fulfilment of these recommendations should increase the transparency of public procurement market and implicitly the effectiveness of public expenditure.

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