

Public Procurement Reforms in Japan: Local Challenges for Social Outcomes

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Abstract

The reform of public procurement has been controversial not only in the political dimension but also in the discourse of public management in the post-New Public Management era. In Japan, after a shocking bribery scandal in which the politicians and major construction companies were involved in the 1990s, the central and local government introduced an 'open and competitive tendering system' to make tendering open, fair, and more competitive. It was followed by the promotion of the 'E-tendering system' to purchases goods and services through electronic application. Reformers expected that these measures would promote the transparency and efficiency of public procurement, and consequently, contribute to the restoration of public trust in the government.

However, the competitive tendering does not always improve the quality of public services. Bidders might employ unskilled, low-wage workers or temporary workers for the lowest price in the bidding. This is called 'social dumping.' In addition, the competitive tendering tends to discourage small firms in the public procurement, and consequently, damages local economy.

To ensure the 'best value' of public procurement, the government of Japan introduced a 'comprehensive appraisal system' that combines price and technical skills of the tenderer. Using the same system, local governments take into account 'social outcomes' in the public works contract in various ways. In addition, local governments face challenges in establishing the 'public contract regulation' to ensure the minimum wage (living wage) standards for the workers working under the public procurement contract. However, these local challenges remain small steps.

Keyword: Public procurement, Public Contract Regulation, Social outcomes, Japan

1. Introduction

Public procurement refers to the government's activity of purchasing the goods and services needed to carry out its functions from the third parties. It ranges from the construction of public infrastructure such as dams and highways to the provision of social care and health services in the communities. A public body may bid for government work against private sector organizations through a formal competitive process defined in the public contract. In principle, the lowest priced tender wins in the competitive tendering. However, the

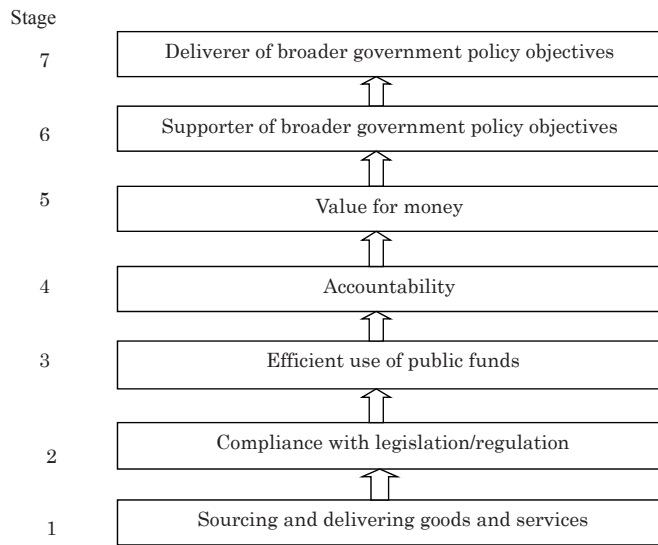
lower price tendering often decreases quality and benefits of the service when it lacks the measures to ensure the 'best value' of the procurement outcomes. In the 80s and 90s, the governments around the world rushed straight towards the outsourcing of the functions of government under a chorus of 'New Public Management.' However, the creation of competitive markets in the public service has created serious problems of fragmented governance, decline in service quality, and worsened working conditions in a 'dog-eat-dog' competition, although it might contribute to the improvement of customer services to some extent.

To respond to these problems, reform-oriented countries have moved on to reform public procurement systems. Firstly, reformers introduced guidelines on 'value for money' (VFM) that takes into account the life-cycle cost—all costs of acquiring, owning, and disposing of infrastructure. It was followed by the 'green procurement' wherein eco-friendly goods are purchased in public procurement. 'Green procurement' has quickly spread around the world including Asian countries (Linda, *et al.* 2010). Thirdly, the Anglo-American countries such as UK, US, Australia and New Zealand took actions to utilize public procurement for social policy outcomes (Arrowsmith 1997; McCrudden 2004; Lawther and Martin 2005; Barraket and Weissman 2009). Their strategies are often called 'social procurement' or 'sustainable procurement.' The fourth is the public contract regulations prevented 'social dumping' and promote compliance with social and labor rights including collective agreements. Finally, it became possible to include the use of 'E-tendering' in the public procurement reforms. 'E-tendering' is widely welcomed by the governments mainly for two reasons; the reduction of paper works and the anti-corruption in public procurement. In principle, adoption and promotion of public procurement reform strategies depends on local context and political condition of a respective country.

2. Public Procurement Reforms in Progress

In Europe, it is notable that a regional body plays a leading role in the promotion of public procurement reforms. In 2004, the European Parliament and the Council Union approved the Directives 2004/18/EC (Public Procurement) that defined the coordination of procedures for the award of contracts in public works, public supply, and public service. It offered a scope for taking account of social considerations, provided that these are linked to the subject-matter of the contract. It was followed by the guideline titled 'Buying Social: A Guide to Taking Account of Social Considerations in Public Procurement' in 2010. This Guideline aimed to raise contracting authorities' awareness of the potential benefits of socially responsible public procurement and to explain in a practical way the opportunities offered by the existing EU legal framework for public authorities on taking into account social considerations in their public procurement for the best value for money. In January 2014, the European Parliament has revised the Directives 2004/18/EC to provide a new criterion of the "most economically advantageous tender" (MEAT) in the award procedure putting more emphasis on quality, environmental considerations, social aspects or innovation while still taking into account the price and life-cycle-costs of what is procured. A Press Release of the European Parliament stated that "the new criteria will put an end to the dictatorship of the lowest price and once again make quality the central issue. To fight social dumping and ensure that workers' rights are respected, the new laws will include rules on subcontracting and tougher provisions on 'abnormally low bids'" (Press Release, January 29, 2014). The press release also stated that contractors that do not abide by EU labor laws may be excluded from bidding (*ibid.*).

It will be ensured that the time has come for the governments to challenge the strategic use of public procurement for policy outcomes with the tide of post-New Public Management reforms. For instance,



Note: Figure adapted from Harland, Telgen, Knight, Callender, and Thai. (2007), p.352.

Figure 1 Stages of public procurement reforms

in 2010, the Australian Federal Government announced an enhanced Indigenous Opportunity Act that requires each tenderer to submit a tender plan for providing training and employment opportunities to local indigenous communities and for the use of local indigenous suppliers that are small and medium enterprises (Burkett 2010). The UK enacted the Public Service (Social Value) Act in 2012 to support the development of community-based social enterprises through the public procurement process. Similar procedures have been introduced in New South Wales, Australia (Burkett 2010).

On the other hand, it should be recognized that most of developing countries are still striving for the establishment of a fair, transparent, and competitive tendering system of public procurement. In their book titled *Public Procurement: International Cases and Commentary*, Christine Harland, *et al.* laid out the stages of public procurement reform as Figure 1. It will be possible to say that most of developing countries remain at the stage 2 or 3, while some advanced countries reach at the stage 6 or 7.

The development of public procurement reforms in the Asian region is quite diverse. Japan, Korea, Taiwan, China, Hong Kong, and Thailand promote the 'Green procurement' (Linda, *et al.* 2010). 'E-Procurement' has been practiced in Singapore, Korea, Japan, the Philippines, and Malaysia. However, as David S. Jones notes, most of Southeast Asian countries still strive to fight corruption (Jones 2009). How about Japan? Japan has been criticized for corruption in the public procurement called 'dango' (bid-rigging) for many years (Woodall 1997). Has Japan changed after the bribery scandal in the 1990s? In the following sections, the author will explore the characteristics of public procurement reforms in Japan.

3. Public Procurement in Japan

Japanese public procurement system remains basically unchanged since the late 19th century (Ohno 2004). In 1889 national government enacted the Public Accounting Law referring to public procurement laws

from European countries such as in France, Belgium, and Italy. The Law established the 'iron rule' of the lowest tendered prices through competitive tendering. The Law states that procuring entities shall provide the ceiling price evaluated in advance—'Predetermined Estimated Price,' and a contract is awarded to the tenderer who has submitted a tender of the lowest price under the ceiling price. This is based on the philosophy that competitive tendering will result in greater economic efficiency in terms of cost saving. However, in 1921, national government revised the Public Accounting Law to add the 'designated competitive tendering system' (selective tendering system) and 'discretionary contract' (single tendering) to ensure the quality of public works and services. It gave more chance for the Zaibatsu conglomerates to occupy the awards in the public procurements. This was the beginning of notorious 'dango' (bid-rigging) system in Japan.

After the World War II, the government enacted the Antimonopoly Law in 1947 and established the Fair Trade Commission to monitor the fairness and competitiveness of the public procurement process. In tandem with the promotion of competitive tendering, the government introduced the system of pre-registration to ensure the ability of the tenderers in the public works contract (Ohno 2004). It classifies construction companies into the ranks from A to E in terms of their abilities (the amount of completed works, equity capital, the number of employees, technical skills, etc.). In the public works procurement, only the qualified construction companies are allowed to participate in the tendering. This is the 'designated competitive tendering system.' Though the Public Accounting Law defines the open competitive tendering system as the rule of bidding, the Ministry of Construction prescribed the designated competitive tendering system to a large scale public construction projects. Consequently, 'dango' has survived. 'Dango' is a negotiation among the bidders to designate a winner in the bidding. After the notification of the tendering by the procuring office, then, construction companies negotiate each other to designate a 'winner.' The designated firm submits a high bid and its "rivals" bid still higher and closer to the predetermined estimated price, maintaining the illusion of competition (Pabor and Ishida 2012). However, the predetermined estimated price is not disclosed until the bidding is over. How can they know the ceiling price before bidding?

4. Public Procurement Reform after the Bribery Scandal

In the early 1990s, a big bribery scandal shook Japan. The Public Prosecutor Office arrested the former Vice Prime Minister, the Minister for Construction, two prefectural governors and two mayors for bribery charges. It revealed the involvement of politicians and public officials in the 'dango' bidding (Woodall 1997). After the scandal, the government took actions to eliminate 'dango' from public procurement. In 1994, the government introduced the 'open competitive tendering' in the large scale construction contracts. It is followed by the enactment of the Proper Tendering Contracting Law in 2000 that defined the basic policies on transparency, fair competition, appropriate practice, and the elimination of illicit activities in the public procurement processes. In the same year the government enacted the Public Service Ethics Law. The Article 3 (3) of the Public Service Ethics Law defines, 'In exercising the authority granted by laws, officials shall not conduct any acts that may bring about suspicion or distrust from the citizens such as receiving any gifts, etc. from any person upon whom the officials exercise their authority.' Furthermore, the government enacted the Act on Elimination and Prevention of Bid-Rigging in 2002. It has strengthened the investigation authority of the Fair Trade Commission against 'dango' bidding and defined the compensation of damages against the public officials who committed in 'dango' bidding.

These measures have contributed to the elimination of 'dango' in the public procurement in Japan. However, the promotion of open competitive tendering has accelerated the 'low price bidding' in public procurement. To ensure the quality of public construction works, the government has established the minimum price requirement system in the bidding proposals and the Low-price Tendering Review by the Fair Trade Commission in 2004. Furthermore, in 2005, the government enacted the Law for Ensuring the Quality of Public Works that required the procuring entities to take into account the 'value for money' in the public works contract. It is a revolution in the history of public procurement in Japan. In the implementation of the Ensuring Quality Law, the Ministry of Land, Infrastructure, and Transport (MLIT) published a guidebook to promote 'comprehensive evaluation tendering system' that takes into account both price and quality for the best value. The quality of the tenderer will be assessed in terms of technical skills, credibility and social skills (contributions), and advanced technology. As examples of social skills, the guideline suggests the disaster relief agreement with local government and community voluntary activities such as road cleaning services.

However, in parallel with the public procurement reforms, the government has introduced a measure to promote outsourcings and concessions of the public service delivery. In 2003 the government amended the Local Autonomy Law to allow local governments to transfer the management of public facilities to the private organizations designated as the 'designated administrative institutions.' Most local governments have swiftly privatized most of their public facilities. Furthermore, the government enacted the Public Service Reform (Market Testing) Act in 2006 that introduced competitive sourcing in the public service provision. In the establishment of a public contract, procuring officers have reduced the budget in terms of efficiency gain. Consequently, competitive tendering and concession contract have resulted in the lower wages and unsafe working conditions of the employees working for service delivery.

To cope with the criticism that the government has increased the 'working poor' through the public procurement, the government enacted the Public Service Basic Law in 2009. It ensures decent working conditions and work environment of persons engaged in the delivery of public services and the provision of safe and good quality services in a reliable, efficient and proper manner. The Japanese Trade Union Federation (RENGO) has appreciated the enactment of the Public Service Basic Law, saying that it will be a first step for establishing a society with fairness and partnership rather than efficiency and competitiveness (RENGO 2009).

5. Local Challenges for Public Procurement Reforms

As mentioned before, the Law for Ensuring the Quality of Public Works in 2005 takes into account the 'value for money' in the public works contract. However, local governments are tasked to promote the strategic uses of 'comprehensive appraisal system' for policy outcomes. In 2012, 60 % of local governments have introduced some kinds of 'comprehensive appraisal systems' in the competitive tendering and bidding process. For instance, the government of Yokohama City certifies private companies' social contributions and gives consideration to the certified companies in the competitive bidding. Other local governments certify various social skills including the employment of disabled person and local workers, the use of local products, the engagement in community voluntary works such as road cleaning service, and the establishment of the disaster relief agreement with local government and will be given considerations in the public contract.

In tandem with local governments, the central government takes a step towards the strategic use of public procurement for policy outcomes. In 2007 the government enacted the Green Contract Promotion Law that

defined the responsibility of national and local government in the reduction of emission of greenhouse gases in the public procurement. Furthermore, the government enacted the Act on the Promotion of Procurement from Facilities for Disabled Workers in 2012 that requires the national government to give consideration to private companies that achieve the employment of the disabled person in the public contracts. These legislative actions suggest that the public sector of Japan takes a small step towards sustainable public procurement.

Another local challenge is a legislation of 'public contract regulation' that ensures the minimum wage (living wage) standards for the workers working under the public procurement contract. The national association of local public service labor unions has proclaimed to the local public managers to enact local regulations to prevent 'social dumping' in the public procurement. In 2008, the government of Noda City enacted the public contract regulation that defined the minimum wage standard for the workers working under the public works contract. Since then, a dozen of local governments enacted similar regulations. In 2010, the government of Kawasaki City enacted the public contract regulation that covers workers both in public works contract and the public service contracts. However, local challenges for ensuring workers' right remain partial. It is mainly due to the strong opposition of the construction industry. Therefore, local governments require national government to enact the Public Contract Bill for ensuring workers' right.

6. Inside Bureaucracy

It is clear that the traditional rule of 'the lowest tendered price' is now outdated. It rather accelerates the low price tendering that resulted in the worsening working conditions of the workers. The promotion of 'comprehensive appraisal system' and public contract regulation by the local governments is major effort to make public procurement workable for the sustainable future of the communities. In the promotion of sustainable procurement, it seems unavoidable to change the traditional 'arms-length' competitive tendering procedures. In the UK, for instance, procuring officers hate to negotiate with third parties because they believe that they need to be 'whiter than white,' and, consequently, this creates a risk averse culture in the public sector (Erridge and Greer 2002: 509). Probably, the 'E-procurement' system is the most desired approach for those public officers who hate negotiations. This is also true in Japan. The public manager should know that the public procurement reforms come up with the strong drivers of change that seeks co-production of services (Bovard 2006: 98). Public officials should talk with the third parties when they seek the 'best value' of public procurement. Erridge and Greer state;

'When progress in implementing long-term partnerships was made, stocks of social capital brought benefits to both departments and suppliers by increasing access to resources and information, reducing transaction costs, improving contract specifications, facilitating shared risks, and improving co-operative action.' (Erridge and Greer 2002: 518)

In long-term partnerships, however, relationships and social ties can create problems if departments and agencies develop favoritism towards one supplier (Erridge and Greer 2002: 517). However, as Tonny Bovard observed, public-private collaboration in the public procurement process can be a step for local government to establish new partnerships with the market (Bovard 2006).

In the case of Japan, the promoters of collaborative procurement will encounter the problems inherent

to the bureaucratic culture. The first is a lack of competency of the public servants. Procuring officers usually get transferred to another department in a short term period not to be acquainted with the tenderers. In this situation, it is difficult for public officials to enhance competency for the strategic use of public procurement. Secondly, there is a lack of leadership in the public procurement reforms. Political managers are difficult to be independent of economic interests. When political managers are reluctant to reform, for instance, for the elections, who can initiate the reform? Thirdly, there is a lack of collaboration among agencies and departments in the public procurement process. As argued, the promotion of outsourcing has increased the number of stakeholders in the delivery of public services (O'Tool *et al.* 1997; Rhodes 2007). In this networked governance, it is necessary for local government to strengthen the power and skills of coordination for the best use of limited resources. It requires a 'Whole-of-Government' approach in the public procurement process as well. However, all of the above problems remain untouched.

7. Conclusion

After the Great East Japan Earthquake in 2011, a number of local governments have established disaster relief agreements with the local private firms. It indicates that local governments have seen local private firms and their employees as a part of the public service system since the Earthquake. In other words, local governments use the competitive tendering system to enhance corporate social responsibility (CSR) of the private firms. The author admits that a system of competitive tendering is necessary for fair competition and lowering the price of tendering. However, economic value is not sufficient for the 'best value' of public procurement. For the best use of resources, it is necessary to pay attention to the long term social benefits rather than short term economy.

In addition, it is important to define the rule for ensuring living wages and working conditions to protect workers' rights. It should be reminded that the competitive tendering is, in principle, a system to select 'good' firms that can spend public money the most wisely in terms of the welfare of community. On the other hand, it should also be recognized that 'the lowest price is the best' serves a cozy triangle of big business, politicians, and bureaucrats. The fairness, transparency, and competitiveness are the necessary condition for public procurement reforms. In the promotion of the best value procurement, however, it is indispensable to embed new philosophy of collaboration and partnership in the public procurement procedures. In this regard, most of Asian countries including Japan remain at the entry level of reforms. To ensure good governance of public procurement process, the governments need to establish a third party organization to check the fairness in the competition and evaluate the performance of public work and service contract applying the criteria of 'best value.' However, these issues remain unchallenged in Asia.

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