Corruption under the Structural Outlook of Market Competition: Public Procurement in China

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Abstract

The relationship between market and corruption has attracted wide scholarly attention in recent years. Conventional wisdom holds that increased economic marketization reduces corruption. China’s case, however, provides evidence to the contrary: corruption gets increasingly rampant as its market-oriented reform deepens. The paradoxical situation of co-development of market and corruption begs the intriguing question of why and how corruption survives market competition. Extending the conceptual framework of institutional theory about formal and informal rules and using public procurement as a case, this paper shows that many formal rules pertaining to market competition in China have been modified, circumvented, or replaced by informal rules that favor corruption. Public procurement has the structural outlook of market competition but not the essence of competition. When the state under-regulates or ill-regulates the market, procurement actors such as government officials and private firms have various opportunities to distort competition mechanisms. Our findings indicate that economic liberalization does not necessarily lead to a reduction in corruption.

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Conventional thought holds that increased economic marketization reduces corruption, which may be broadly defined as the abuse of entrusted power for private gain, if we use the Transparency International's definition. Some scholarly works also suggest strong correlation between corruption and market development (Ades and Di Tella 1997, Broadman and Recanatini 2001, Geol and Nelson 2005, Goldsmith 1999, Montinola and Jackman 2002). It is observed that corruption tends to develop more rapidly and rampantly in the countries where governments hinder market competition than those with well-established market institutions and a very limited economic role for the government. Corruption and market competition are thus negatively associated (Ades and Di Tella 1999, Giavazzi and Tabellini 2005, Gurger and Shah 2005, Iwasaki and Suzuki 2012).

While this proposition largely holds true in theoretical terms, empirical findings from China indicate that the relationship between market and corruption is more complex and nuanced than conventional wisdom suggests. Some thirty years ago, China began to introduce market mechanisms in order to jump-start the economy, which had been bogged down in sluggish development due to bureaucratic central planning for decades. Since then, various market institutions including, *inter alia*, public procurement, have been adopted in the public and private sectors. The market-driven reform triggered phenomenal economic growth and propelled the country to the top rank in global economic performance. The spectacular economic development in China nevertheless has coincided with rapid escalation of corruption. While in the early reform period, the Chinese government was only worried about small-scale “unhealthy tendencies,” (Myers 1989), today it is confronted by corruption as a
full-fledged social problem and a crisis for its governance. This is evident in the fact that an increasing number of high-level party and government officials get implicated in corruption activities each year; corruption continues to pose a huge drain on the state coffers; there has been increased collusion between officials and business people so that corruption becomes more of a collective undertaking than a camouflaged individual act; and the latency period, defined as the time from which corruption was committed to when the case is uncovered, has become much longer than before, indicating the greater difficulty experienced by anticorruption agencies in detecting corruption.\(^1\) At the recent 18th Congress of the Chinese Communist Party, the top leaders made the alarming statement, for the first time openly and unequivocally, that corruption was fatal to the Party and could topple the regime if not contained (Li 2012).

Whereas it is subject to debate whether corruption is sequential or consequential to China’s market reform among scholars (Wedeman 2012, Gong and Ma 2009, Sun 2004), obviously the introduction of market institutions has not effectively alleviated corruption. The paradoxical situation of co-development of market and corruption begs the intriguing question of why and how corruption has been able to survive market competition. Using public procurement as an example and drawing on fieldwork conducted in China, this paper examines why the China case does not follow the theorized trajectory of containing

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corruption by marketization and what implications we can learn from an empirical analysis of the relationship between corruption and the transition to the market in China.

Public procurement has grown rapidly in China in recent years, as a result of the move toward collaborative models of governance, driven partially by the new public management movement but perhaps more by the imperative for marketization in China's context. The government has relied on “proxy administration” (Meier 1993, 189) by delegating or outsourcing the provision of goods and services to nongovernmental entities, or establishing various forms of public-private partnership. The absolute value of government procurement increased more than eleven times from 2002 to 2012 (Yu 2012). However, our findings indicate that economic liberalization does not necessarily lead to a reduction in corruption. Instead, public procurement has become an area highly susceptible to corruption where informal rules in favor of special interests have prevailed, despite the various efforts to promote free competition and reduce the government’s overall intervention in the economy. Extending the conceptual framework of institutional theory about formal rules and informal rules to the China case, this paper suggests that market competition and regulation should go hand in hand and marketization must be guided by “hard rules.” Corruption flourishes when competition is un-regulated, under-regulated, or ill-regulated with managerial officials continuing to enjoy a high level of discretionary power.

This paper is based on the fieldwork conducted in a median-size Chinese city, City X, during the period 2009 – 2010. City X is chosen as a representative case because it mirrors the national average in both the value and volume of government procurement. About 20 interviews were conducted with the people who had participated in procurement in various
capacities, including officials of the Government Procurement Centre and the Bidding Office and business suppliers. We also conducted interviews at the government agencies responsible for overseeing bidding activities such as local Discipline Inspection Commission, Fiscal Bureau, and City Construction Management Bureau. The empirical data of this paper also come from official documents and media reports nationwide.

The rest of the paper is organized as follows. It begins with an overview of the conceptual approach of this study — the relationship between formal and informal rules. It then goes on with China’s case by detailing what kind of formal and legal requirements and regulations are in place to govern public procurement. Empirical evidence is presented in the third section to show what has actually been practiced in the procurement process. Finally, in the last section, we provide some explanations for the dual operation of formal rules and informal rules in China and draw conclusions on the implications of China’s case for a better understanding of relations between market and corruption.

**The Conceptual Issue: Formal Rules vs. Informal Rules**

We draw in this paper on an important conceptual framework of institutional theory: formal rules vs. informal rules. The word “rule” may have different meanings to different people, but a general understanding is that rules regulate practices by defining their routine patterns, processes and procedures. Thus, in the legal field, a rule embodies actionable dominant logic, backed by lawful sanctions. In policy-making, rules are developed to elaborate and frame conflicts embedded in various areas of governance (Rein and Schon 1977).
For new institutionalists, the sources of a rule may vary. Rules may be made through a legal process of rule making. However, they can also be formulated through the practice of political and societal actors, which gives rise to regular patterns of behavior. In the former, rules are consciously designed and codified in written form and enforced by external authority, thereby resulting in formal rules. Constitutions, laws, and government decrees are good examples of formal rules. In the latter, rules are formulated in an informal fashion as they evolve spontaneously, though not always unintentionally, over time through human interactions. Informal rules stem from customary behavior patterns and local norms when “all (or most) actors find it beneficial to adhere to them (as long as others do too)” (Skoog 2005). They are considered as “informal” because they operate at the margin or beyond the framework defined by the state as unwritten yet widely accepted codes, routines, and norms (Pacheco et al. 2008).

Formal and informal rules interact in various ways. Some scholars argue that their relationship is largely complementary to each other and formal and informal rules work conjointly to prescribe what would be considered as appropriate behavior. Gun Eriksson Skoog (2005, 23) suggests, for example, that formal and informal rules are functionally interrelated. “Since there is neither possible nor desirable to design detailed formal rules for all possible and specific recurrent situations informal rules are needed to complement the formal rules.” This argument holds true to some extent, but we argue that the relationship between informal and formal rules is not one-dimensional but rather multifaceted.

To begin with, although informal and formal rules co-exist and interact with each other, they may develop separately. Informal rules may grow despite or because of formal ones and functionally independent of the latter. The two are not necessarily complementary with each
other or mutually reinforcing. Furthermore, informal rules may not help deal with the problems associate with formal rules, but may instead create problems for formal ones. When the adoption of formal rules is not in line with or supported by informal rules in reality, the authority of formal rules will be undermined by the significant discrepancy between what is stated and what is practiced. Thirdly and what is worse, when informal rules do not adapt to formal ones, they may develop spontaneously to the extent that they actually reject and replace formal rules to become the prevailing prescriptions for social behavior. As a result, the formal rules remain on paper and stay in form only, while informal rules take precedence over formal ones to constitute the “codes” for behavior in practice. This situation is best described by the notion of “rules-in-form vs. rules-in-use” coined by Ostrom, who correctly pointed out that “many written statements have the form of a rule … but … do not affect behavior. Such statements are considered rules-in-form rather than rules-in-use” (2005:138). Ostrom warned, accordingly, that one should focus on rules-in-use rather than rules-in-form in order to identify the presence of an institution (1999:38). The essence of Ostrom’s notion is that informal rules, though crafted outside the official channels, can not only co-exists with formally sanctioned ones but may also substitute the latter to actually guide the way in which people behave. The “taken for granted informal understandings,” can be more important than “rules in form” (i.e., formal rules) (Lowndes and Leach 2004, 559).

The empirical analysis of this paper rests upon the above conceptual framework. We set out to examine the dual relationship (complementing or otherwise) between formal rules and informal rules and its consequences. We find that informal rules may resist or even replace formal one. We also suggest that it is important to know about the process, channels and mechanisms through which the institutional change of informal rules circumventing formal
ones takes place. As informal rules need not to be in writing nor officially sanctioned, they are
crafted and changed intentionally or unintentionally by human beings as a result of their
responses to challenges arising from surrounding environments. Ostrom made it
straightforward by referring rules as “strategies adopted by participants within ongoing
situations” (Ostrom 2005, 18). Our findings in the next sections indicate that informal rules
are socially embedded. The inner logic of why actors do what they actually do derives from
the specific situation and larger context they find themselves confined to and what makes
sense to them as rational responses in such situation — from their own point of view (Skoog
2005, 10). On the other hand, the development of informal rules is related to formal rules and
oftentimes as a result of the latter’s inadequacy or impotency. The rise of corruption in the
context of market competition in China’s public procurement illustrates the two dimensions
of formation of informal rules — spontaneously and in response to formal rules. The interplay
between the formal rules and informal ones shows how the formal rules are captured,
modified or superseded by the informal ones in China’s government procurement.

**Formal Rules: the Call for Market Competition in Public Procurement**

By market competition, we mean in a narrow sense the adoption of bidding and tendering
methods guided by the principles of openness, fairness, and impartiality. In China market
competition had never existed until the country began its economic reform in the early 1980s.
Aiming at transforming the centrally planned economy to a market one, the reform brought
dramatic changes to the country. One of these changes was to introduce bidding and tendering
practices when assigning public projects. The Chinese government employed a set of
competitive bidding steps for contracting out public projects in the construction sector first, which were financed by international institutions such as the World Bank. After conducting pilot bidding schemes in several provinces including Guangdong, Yunnan, and Jilin provinces in the early 1980s, the government found that competitive bidding could not only reduce costs and construction duration for contracted projects but also help increase the transparency of decide-making processes and contain officials’ discretion in project allocation.

In light of the success of these pilot bidding exercises, the Chinese government decided to further promote market competition in government contracting in the 1980s and 1990s. After bidding activities had quickly developed in the construction industry, other areas began to follow suit; competitive bidding, for example, took place in the procurement of complete sets of machinery, medicine supplies, scientific research projects, and infrastructure projects financed by foreign funds.

At the same time, the government began to normalize bidding activities by laws and rules. At the local level, some provinces that had conducted pilot projects took further steps to adopt procurement-related rules and regulations. In 1998, Shenzhen City became the first one to introduce rules for government procurement. It identified several bidding methods for goods purchases, specified the conditions under which a method should be used, and detailed the bidding process for each method. Similar local rules were adopted in other provinces subsequently. At the central level, the Ministry of Finance issued some trial provisions, such as the “Provisional Managerial Rules for Government Procurement” (zhengfu caigou guanli zanxing banfa), to urge central and local government units to use bidding methods for purchasing certain goods such as office equipment.
These local practices as well as the pilot bidding exercises prompted the formulation of two important national laws. The Law on Bid Invitation and Bidding (LBIB) took effect on January 1, 2000 to regulate bidding activities. In the next year, China became a member of the World Trade Organization, and was required both to join the Government Procurement Agreement and to open its market of public procurement to international suppliers. This impelled the Chinese government to take further measures to learn and practice the commonly used competitive bidding methods in international trade. In 2003, a second national law for public procurement, the Government Procurement Law (GPL), was adopted.

The two laws constitute the legal and institutional framework of China’s public procurement. They govern different aspects of public procurement. The GPL guides government procurement and clarifies rights and responsibilities. Specifically, government procurement applies to the purchase requests made by state organs, public service units, and social groups for goods, services, and construction works that are included in the centralized procurement catalogues and involve more than a certain amount of money.\(^2\) The LBIB, on the other hand, mainly deals with activities concerning the procurement of construction services for public projects, referred to as works procurement in China.

The two laws set the formal rules governing public procurement in China concerning its processes, methods, and guiding principles. In terms of bidding processes, the two laws stipulate that a bidding should normally comprise five steps: 1) the purchase institution should issue an advance notice publically (e.g., on government websites or in newspapers) to call for

\(^2\)The centralized procurement catalogues are issued by governments at different levels and therefore vary across different jurisdictions. The “certain amount of money” is specified by each of these governments and applies only to its administrative zone.
bids; 2) suppliers then submit individual sealed bids, including specific information on the
proposed price, anticipated quality, technology to be used, expected delivery date, and
financial statements according to the notice; 3) after the deadline, bidding agencies open the
sealed bids and show details to all bidders; 4) once the bids are open, an bid evaluation panel
consisting of experts and representatives from the purchase institution will assess and score
every bid according to the criteria set in advance; and finally 5) the contract of a procurement
project will be awarded to the bid with the highest score, if no protests are made. In such a
competition process, a bid winner who offers a lower price and better services and has a good
business reputation tends to win government contracts.

A variety of bidding methods are set up within the framework of the two national laws
to induce competition among firms (Table 1). The LBIB introduces two methods to be used:
one is procurement by public invitation and the other by invited bidding. The GPL mentions
three additional methods; namely, competitive negotiation, single-source procurement, and
inquiry about quotations, while stating that any other methods approved by the State Council
are also acceptable. Among these five major procurement methods, the first four entail
competition in varying degrees. The first one, public invitation, is considered the default in
public procurement. If a procurement project involves more than a certain amount of money,
it must go through a procurement process involving the public. The public invitation method
requires that information about a bid invitation should go public to attract as many suppliers
as possible. The second procurement method, invited bidding, is used where the goods or

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3 The specific amount varies by jurisdiction. For example, it is half million yuan in Gansu province and one
million yuan in Tianjin.
services in question are special in character and can only be procured from a limited number of suppliers and where the cost of public invitation forms an excessive proportion of the total value of the government procurement items. ⁴ Thus, with the approval of a local government, a purchase institution may send bid invitations to a few firms or organizations it deems suitable and appropriate. The remaining three procurement methods are supposed to be adopted only under very limited conditions as they generally involve fewer firms to compete than the first two. Competitive negotiation may be used only if no suppliers have come forward before the bid submission deadline for public invitation or invited bidding. Still, in a procurement project using this method, bid invitations should be sent to at least three suppliers; and the representatives of the purchase institution will then discuss and bargain separately with each bidder, in order for them to compare the bids and recommend one to the bid inviter. Inquiry about quotations, a much simpler method only for goods procurement, can be adopted when the specifications and standards of the goods in question are uniform, the supply for spot transactions is sufficient, and prices fluctuate very little. Using this method, a purchase institution may ask several suppliers to submit sealed price bids. These bids will then be opened at the same time and the supplier with the lowest price will win. Finally, the single-source procurement method will be used in emergencies or when no alternate supplier is available. To sum up, the two most-frequently-used procurement methods in China, public invitation and invited bidding, require competitive bidding. In the other three methods, the

⁴ See Article 29 in the GPL.
degree of competition is significantly reduced, but they are supposed to be employed only in extraordinary situations and hence have very limited applicability.

<table>
<thead>
<tr>
<th>Method</th>
<th>Description</th>
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<tbody>
<tr>
<td>Public invitation</td>
<td>A bid inviter, in the form of a public bid announcement, invites unspecified legal persons or organizations to submit bidding proposals.</td>
</tr>
<tr>
<td>Invited bidding</td>
<td>A bid inviter sends bid invitation documents to three or more legal persons/organizations, according to certain qualifications, to invite them to submit bidding proposals.</td>
</tr>
<tr>
<td>Competitive negotiation</td>
<td>A purchasing institution or procurement agency directly invites at least three bidders to negotiate.</td>
</tr>
<tr>
<td>Inquiry about quotations</td>
<td>A purchasing institution buys standard goods by sending price-inquiry documents to at least three suppliers. The suppliers have only one chance to offer prices and the one who offers the lowest wins the government contract.</td>
</tr>
<tr>
<td>Single-source procurement</td>
<td>A purchasing institution buys goods or services from one supplier under special conditions.</td>
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Source: Compiled by authors

The two national laws also lay out important guiding principles for public procurement, which include transparency, integrity, fairness, justice, honesty and credibility. The GPL makes it clear in its very first article that “to improve building a clean government, this law is
constituted.” The two laws specifically forbid corrupt activities such as bribe taking and giving among bidders, public officials, procurement agencies, and bid assessors.\(^5\) The government has set up official websites to make bid information accessible to the public and to publicize the outcomes of bid protests, if any. It is expected that with easy access to information on bid invitations, more potential bidders across the country may consider competing for government contracts. The increased number of bidders will then in turn further enhance competition. Moreover, as the general public have access to online information and can see bidding results, if they find a purchasing price higher than those in the market, they may challenge the bidding results.

In addition to the two overarching laws, some other formal rules have been set up to help prevent malpractices in public procurement. This can be seen, for example, in some procurement-related budgetary requirements. As Figure 1 shows, at the beginning of each year, a government unit is supposed to submit a detailed procurement budget as part its departmental budget, and procurement activities must follow the budget. A procurement project outside the budget will not get financed normally. This detailed procurement budget also helps administrative departments oversee public procurement activities. The national treasury transfers procurement payments directly to contractors rather than passing them through individual procurement units or procurement officials. This can make it difficult for any procurement unit to hold back or misappropriate contract payments.

\(^5\) See Articles 25 and 72 in the GPL, and Articles 12, 32, and 44 in the GPL.
Figure 1  An Illustration of Public Procurement Process

It is also worth noting that the Central Discipline Inspection Commission (CDIC) of the Chinese Communist Party (CCP) has made very specific rules in order to maintain the integrity of government officials involved in procurement and to prevent abusing public power for personal gains. It is stipulated that under no circumstances government officials are supposed to interfere with bid invitations and bidding processes. Specifically, they cannot change bidding methods from open bidding to invited bidding or dismantle large projects into small pieces for any reasons; and they are not allowed to circumvent bidding requirements using as excuses information confidentiality or urgent relief works. The CDIC also makes it clear that government officials cannot appoint bidding agencies for purchasing institutions or force these institutions to delegate the bidding service to a third party. Nor can they require
bid winners to subcontract projects to others, or force them to use construction materials and machines from a particular supplier. Influencing bidding evaluation and altering bid winners are treated as official misconduct and strictly forbidden.

These formal rules of public procurement are back up with institutional supervision for their implementation. The local party discipline inspection commissions across the country are charged with the supervisory mission. They are expected to keep a close eye on corruption and other forms of misconduct in public procurement. Local disciplinary officials stand by in a bidding process to ensure that rules are followed and no one acts illegally. If bid protests or corruption reports are received, they will follow up immediately to investigate alleged corruption conduct.

**Circumvention of Formal Rules**

All the foregoing suggests that the Chinese government has made some progress in promoting competition in public procurement. It has managed to establish a formal regulatory framework, which consists of carefully designed formal-legal rules and institutions, to prevent malpractice in tendering and bidding that may obstruct market competition. However, these formal rules have proven far from being effective and have oftentimes been distorted or superseded in practice by various informal rules in favor of special interests. Thus, while formal rules prohibit government officials from interfering with bidding competition, informal rules have in fact worked to facilitate corrupt collaboration between officials and private bidders. While chopping large projects into small ones is officially forbidden, some government units find it practically acceptable and do it anyway when purchasing goods and
services so that they can get around the requirement for competitive bidding to use their favored companies as suppliers.

There is perhaps nothing new about the existence of a symbiotic relationship between market and state actors in transition economies. Scholars have pointed to the existence of strong and intimate relationships between state officials and private entrepreneurs in China (Liu 2011). Yet, how the relationships have been formulated and have bypassed formal regulations remains understudied. The processes and mechanisms through which informal relations, roles, and rules circumvent the formal ones merit special attention. Our research identifies several major patterns in which the formal rules of market competition are distorted or replaced by corruption-prone informal rules.

**Evasion**

The first common way is to evade the bidding process as early as the planning stage of a particular procurement project or wherever possible thereafter. In China, government procurement formally starts with a departmental procurement budget. The Centralized Purchasing Catalogue for Government Procurement stipulates what items should be purchased through public procurement. Before purchasing a listed item, the purchase institution must include the estimated expenditure of that item into its institutional budget and get the budget approved. It means that at the beginning of a year, a government bureau should indicate in its budget the plan to purchase certain items and give an estimated cost with justification. Once the purchasing plan is approved, the budgeted amount will be allocated to the procurement account of this bureau. The bureau will then submit a request to the local Government Procurement Management Section for setting up a procurement project, and the Section is expected to endorse the request after verifying the budget allocation of the
proposed procurement. After that, the Section will transfer the project to the Government Procurement Center to execute the procurement and select a supplier through a bidding process. Upon receiving and checking deliveries, the bureau issues a receipt to the Section, and the latter will inform the treasury to pay the supplier directly.

This workflow shows the standard procedure of government procurement. At the same time, it indicates that without a procurement budget, a purchase institution does not have to go through a bidding process. Instead, it can not only choose suppliers itself but also exercise discretion on procurement spending. In other words, purchase institutions may evade the formal rule for bidding and tendering by manipulating its budget.

As shown by the official reports of the National Audit Office, it is not rare that some government departments excluded from their budget the goods and services that were listed in the Purchasing Catalogue and supposedly purchased through a bidding process. In 2009, four out of 56 institutions in the first budget tier at the central level (zhongyang caizheng yiji yusuan danwei) did not properly budget certain procurement projects and, as a result, these projects did not employ a bidding method (National Audit Office 2010). The Executive Office of the Three Gorges Project Construction Committee, for example, did not draw up a government procurement budget for purchasing office equipment such as copy machines. In another case, the Executive Office of the South-to-North Water Diversion Project Construction Committee evaded bidding competition by excluding 12 million yuan from its procurement budget, which was spent on a special audit service. These institutions were able to do so because they claimed that these items were paid by special funds (zhuanxiang zijin),
self-raised funds (zichou zijin) or off-budgetary funds (yusuanwai zijin). The formal procurement rules do not apply to the items purchased through these funds.

As the government intensified its effort to monitor the budget of its units more closely in recent years, evading bidding requirements by manipulating procurement budgets has become difficult. A procurement officer told us, “excluding government procurement projects from departmental budgets was common before but not now”.

Some other methods of evading the bidding requirement have subsequently emerged. A frequently used one is to dismantle large procurement projects into small pieces so that the value of each project will not surpass the threshold for bidding. The formal rule for competitive bidding is that if the value of an item to be purchased exceeds the threshold set by the Purchasing Catalogue, that item must be purchased through a bidding process. By dividing big projects into small ones, purchase institutions can exclude these projects from their budget proposals and conduct purchasing internally without competition. Below is a case in point. According to the Purchasing Catalogue, computers priced at more than ten thousand yuan should be purchased through competitive bidding. Some schools in Suzhou city bought batches of different computer components separately to keep the value for each batch below the threshold specified in the Procurement Catalogue. These components were later assembled into computers (Zhou 2010).

Another common way to evade competitive bidding has developed in connection with the formal rule that public procurement does not apply to the situations of an unavoidable

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6 Interview with a senior officer at a local government procurement center in December 2009.
7 Ibid.
emergency or procurement involving national security and secrets. Under this rule, it is possible to evade competition by claiming that the proposed purchase involves confidential information. Or in some cases, “the purchase institutions purposely delay the initiation of a procurement project to the extent that only competitive negotiation and price negotiation fit the time frame and are thereby adopted” as we were told by an interviewee. In City X, we observed that a purchase institution (in this case, a local education bureau) successfully altered the procurement method for a project involving over 800,000 yuan from public invitation to competitive negotiation using the above excuses.

Capture

Capture is a strategy through which corrupt actors shape the formal rules to their advantage by using them for different purposes from the organically intended. It takes place when purchasing through a public procurement process becomes unavoidable, but there is the need to get around the bidding requirement stipulated by the formal rule. Under this situation, purchase institutions may shift the procurement method from the most competitive one to less or least competitive ones to weaken the regulatory effect of formal rules.

As mentioned before, five procurement methods are commonly employed in China’s public procurement, including purchasing through public invitation, invited bidding, competitive negotiation, inquiry about quotations, or single-source procurement. Among the five, the “public invitation” method has been set by the GPL as the default. It requires a purchase institution or its agency to invite an unspecified and unlimited number of legal persons or organizations to submit bidding proposals and compete for a procurement project.

8 Interview with a local officer at a government procurement center in December 2009.
Hence, compared with other methods, which either set a limited number of competitors or stipulate who can or cannot participate in bidding, the public invitation method usually attracts the largest number of dibbers and produces the most intensive competition. Official statistics indicate that an increasingly larger number of government procurement projects have employed this method in recent years. Statistics seem to suggest that competitive bidding is very common among government procurement suppliers. As some reported, for example, the scale of procurement involving public invitation rose from 48% of the national total in 2002 to 80.7% in 2011 (Yu 2012).

However, this is not true in reality. In the city where we conducted fieldwork, public invitation is not the most frequently used procurement method, while local officials have inflated procurement statistics to meet the top-down requirement for using it as the default. A staff member of the local government procurement center, a public institution for carrying out biddings, provided us with the real procurement figures sorted by bidding methods. In 2009, the scale of procurement through public invitation was 33.77 million yuan in total value, while the expenditures incurred through three other procurement methods — competitive negotiation, inquiry about quotations, and single-source procurement — were 41.48, 23.42 and 4.38 million yuan respectively. Competitive negotiation is clearly the most frequently used procurement method.

Some interviewees even considered the above picture cosmetic. In their view, procurement through inquiry about quotations, which only engages a very limited number of suppliers and is thus much less competitive even than competitive negotiation, was the most
common method in government procurement. We were told that in City X, about 79% (or 130 out of 165) of the procurement projects were purchased through this method in 2009.\(^9\)

The phenomenon of shifting procurement methods is not limited to City X. The director of a district financial bureau in a southwest city shared with us a similar story: inquiry about quotations ranked first among all procurement methods in his district as well. He added, “because purchase institutions often require delivery as soon as possible, we can change the procurement method from public invitation to another method in order to shorten the procurement period”\(^10\). In an audit report, the National Audit Office criticized the China Meitan General Hospital for using the competitive negotiation method to purchase 1.7 million yuan worth of elevators, while public invitation should have been used for making a purchase at this scale (National Audit Office 2010). All these cases indicate that the formal rules regulating procurement methods have been bent to meet local or personal needs, while the prevailing informal rule is that a more competitive procurement gives way to a less competitive one whenever possible.

Shifting procurement methods from public invitation to less competitive ones has a decisive impact on the number of competitors in each procurement project. According to an interviewee, in procurement projects using the methods of inquiry about quotations or competitive negotiation, normally around five suppliers would participate in bidding, while in projects with public invitation the number of bidders is usually more than ten.\(^11\) By changing the procurement method to reduce the level of competition, officials in a purchase institution

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\(^9\) Interviews with local procurement officers and a vendor in December 2009.
\(^10\) Interview with an official at a district financial bureau in January 2010.
\(^11\) Interviews with local procurement officers in December 2009.
can choose their favorite suppliers from a small number of bidders. The fewer the bidders, the more easily officials can determine the winner. Hence, the degree and nature of competition are affected by the procurement method chosen. A procurement officer made it clear, “purchase institutions are inclined to use competitive bidding and inquiry about quotations as procurement methods instead of going through public invitation, because they can easily exert influence over the bidding processes.”

_Hollowing out_

By hollowing out, we refer to the strategy that makes formal rules void of contents so that they exist in form only and give place to informal rules in practice. As a formal rule of public procurement in China, when a procurement project is initiated, officials from the purchase institution are supposed to make and publicize bid invitations. Bid invitations are critically important in government procurement as they provide procurement details, including the information about the purchase institution, specifics of the item(s) to be purchased, bidder qualifications, technique requirements, the template for bid proposals, the scope of bid prices, bid evaluation methods and criteria, and the main contents of proposed contracts. The Chinese government has also made specific regulations prohibiting purchase institutions from showing favor to a particular bidder or product or excluding potential bidders in bid invitations. However, this formal rule is left an empty shell as purchase institutions often add special requirements in favor of a few suppliers in order to for them to get better bid evaluations than others and eventually win the contracts.

12 Interview with a senior officer at a government procurement center in December 2009.
For instance, officials from purchase institutions may specify particular brands in bid invitations to benefit the suppliers of those brands.\textsuperscript{13} Or they may set particular technique requirements so that only a small number of suppliers or a single bidder can win. In that way, as an official put it, “only one bidder can meet all the requirements and it surely gets the highest score in the bid evaluation.” He added that this strategy was very common in government procurement.\textsuperscript{14} As reported, the director of a technical equipment office in a district education bureau even allowed a firm to write technique requirements for the Office’s bid invitation. The firm was thus able to include exclusive technical specifications based on its own products to exclude potential competitors (Li et al. 2011).

Formal procurement rules are hollowed out and merely left on paper not only by procurement officials but also by private firms who compete for government contracts or by the collaboration between the two groups through bid rigging. Bid rigging is a form of fraud that allows a contract to go to a prearranged bidder while other bidders submit bids only to create the appearance of legitimate bidding. Bid rigging has become a common practice in China’s public procurement. A leading official in a municipal bidding management office told us that bid rigging took place in approximately 90\% of the public projects his office had handled in recent years.\textsuperscript{15}

Some informal rules have developed to facilitate bid rigging. A common scheme is that the pre-determined winner invites other firms to apply for the same procurement project.

\textsuperscript{13} Ibid.
\textsuperscript{14} Interview with an officer at a government procurement center in March 2009.
\textsuperscript{15} Interview with a senior officer of a bidding management office in June 2010.
covers their expenses and rewards them after the bidding. Before the bidding begins, this bidder already shared its proposal with the “invited” firms, who have then produced similar ones but at higher prices. These “invited” firms, of course, did not intend to bid in the first place and now join the “race” only to help the pre-determined winner. This practice, referred to as complementary bidding (or peibiao in Chinese) is widely accepted in China’s construction industry. The underlying agreement is that other bidders will take turns being the designated successful bidder to win other contracts. A vendor of geological survey services refers to it as an informal rule in the construction industry that a firm helps another win a public project and, in return, the latter will do the same to make the former a winner in future projects.

In addition to the above conspiracy, bid rigging also takes a form called zizhi guakao (qualification affixing) in China. That is, if Firm A does not meet the requirement specified by a bid invitation in terms of professional qualification and experience, it may use the name of Firm B to bid if the latter meets the requirement but is not interested in submitting a bid for itself. The two firms may reach an agreement privately to allow Firm A to bid as a subsidiary of Firm B so it can use the latter’s professional qualifications to support its bid. The affiliation of course is in name only, as the two firms remain independent of each other in finance, personnel, and project management throughout the whole process. Firm A nevertheless would have to pay for the “service” provided by Firm B as well as all the bidding cost.

Collusion

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16 Interview with a local officer of a bidding management office in June 2010.
17 Interview with a vendor in July 2010.
The formal rule in China forbids the collusion between firms and officials in
government procurement. For example, government units are not supposed to approach
suppliers for procurement, or vice versa. However, this formal rule has been largely replaced
by an informal one; that is, only by collaborating with “insiders,” can films secure
government contracts.

“Smart” firms will begin to contact government officials before the bidding process
starts. “Right after the government releases the bid information of a public project, firms will
actively seek guanxi (connections) or examines their networks to see if there are officials to
contact”.\(^{18}\) The government officials whom firms try to find are usually those who can
influence a procurement process or decision, such as the leading officials of purchase
institutions or supervisory officials. Firms compete in connecting with these officials and
whoever gets the better connections would be more likely to win project contracts. Firms have
various networks. Some of them have access to officials working in the field like those in the
construction section of a purchase institution or a government procurement center, while
others may have strong connections with officials at higher levels such as mayors, municipal
party secretaries, and provincial governors. “The competition in China’s bidding system is
actually a competition for guanxi. The firm who has the strongest guanxi will for sure win the
race”.\(^{19}\)

Collusion between firms and officials often involves advantage transfers under the table.
“Everyone knows that there is no free lunch and the government will not award a project

\(^{18}\) Interview with a local senior officer of a bidding management office in June 2010.
\(^{19}\) Ibid.
contract to a firm for no reason,” said an official in charge of procurement.\(^{20}\) This implies that among the successful firms, few got public projects without having provided benefits to officials. Bribing government officials in order to win government contracts is not a minor problem in China’s public procurement. For example, the former mayor of Huainan City, Chen Shili, helped private firms win bids after receiving numerous gifts. From 2001 to 2006, at least three firms asked Chen to lend a hand in their bidding for public projects concerning a business square, resettlement housing, and some residence areas. These projects earned Chen more than five million yuan, as well as some other benefits in the form of real estate (Shi 2009).

After firms and officials collude to determine project contractors behind the scenes, the formal rules, which would otherwise govern the procurement process, become empty words. Government officials may act in different ways to change the “rules of the game.” They may interfere with the review of bidding proposals and instruct the assessment panel members to give higher scores to a predetermined winner.\(^{21}\) A former director of the Water Resource Bureau in Changde City of Hunan Province, for example, issued a note on behalf of the bureau to ask his subordinates to give high points to a construction company and was “rewarded” 320,000 yuan (Zhao and Ruan 2010) by the company.

One of the major reasons why the officials have the power to determine contractors outside the bidding system and dare to do it is that they have the funding authority over public projects. After a project application is approved, it is the government’s financial department

\(^{20}\) \textit{Ibid.}  \\
\(^{21}\) Interviews with several local officers of a bidding management office in June 2010.
that allocates funds and authorizes the transfer of these project funds from the government to contractors.\textsuperscript{22} Specifically, these officials have the power to decide whether to sign off transfer notices, which instruct the National Treasury to make payments. It is worth noting that firms usually need to raise funds in advance for construction works and get reimbursed by the government after the project is inspected and accepted. Hence, project contractors rely on leading officials of purchase institutions to get back their advance payments as soon as possible.\textsuperscript{23} As a regulatory officer said, “even though a bidder wins a project contract through real competition and does not collude with other firms, there is still a possibility that it cannot get project payments on time”.\textsuperscript{24} As a result, firms in the construction industry do not actively compete for public projects unless they collude with officials beforehand to secure that timely payments will be made. The following case is illustrative. A firm got a contract from the Beijing Office of Shandong Provincial Government for a hotel renovation project in 1996. It had to raise project funds itself and got over 11 million \textit{yuan} as the work progressed. It was nevertheless unable to get the funds reimbursed even after the project was completed until 2011. During the period, the Director of the Office sought a bribe of one million \textit{yuan} from the firm in exchange for approving project reimbursement, but the firm refused (Lyu 2011).

\textbf{Conclusion}

Although the strategies specified above do not represent the whole spectrum of

\textsuperscript{22} Interview with a local officer of a bidding management office in June 2010.
\textsuperscript{23} Interviews with local officers of a bidding management office in June 2010.
\textsuperscript{24} \textit{Ibid.}
possibilities to distort or circumvent formal rules, it is clear that corruption has grown
rampantly underneath the structural outlook of market competition in China’s public
procurement. The official requirement for bidding and tendering and the formal rules
governing competition in government procurement have been replaced by informal rules in
favor of corruption. Our findings show that, while government departments are officially
required to include purchase items in a procurement budget for bidding and tendering, they
try to hide them from the budget whenever and wherever possible so that the items can be
allocated to favored suppliers without competition. Large procurement projects are often split
into small ones in order for the value of each to be kept under the threshold set by the
Purchasing Catalogue for public procurement. If a purchase cannot be made internally but has
to go through a public procurement process, then the procurement method is often altered
from the most competitive one that requires public invitation to the least competitive one
requiring single-source procurement only.

Some prevailing informal rules guide bidders’ behavior. It is not rare to see firms
making efforts to avoid competition as much as they can and seek to strike deals behind
closed doors with government officials. It has become a common practice that firms collude
in bid rigging to satisfy each other’s needs, governed by the unwritten rule that all the parties
involved in the conspiracy will be compensated by cash payments or sub-contracts, or in
some other ways. Informal rules thus shape bidders’ relationships and lead to collusive
corrupt activities. As Grief and Kinston (2011) point out, it is fundamentally the expected
behavior of others that motivates people’s behavior, rather than the formal rules.

Generally speaking, China’s public procurement as it stands now has the structural
outlook of market competition but not the essence of competition. Competitive bidding is
exercised only in a limited scope; the number of bidders is usually small; collusion between firms and officials goes rampant; and bid rigging occurs often. As a result, public procurement fails to fulfill its original promises of curbing corruption and increasing efficiency in the provision of goods and services. An investigation of the spending on more than 110,000 office products in four provinces (Guangdong, Heilongjiang, Jiangxi and Fujian) reveals that over 80% of them were purchased at a price at least 1.5 times higher than the one in the market and some even exceeded the market price by 6 or 7 times.

However, the problem is not with the formal rules, as there is no lack of rules in China to govern government procurement. Yet, informal rules have developed in parallel to formal ones and have disaggregated, reformulated, and replaced the latter to influence the behavior of various players in the procurement market and to determine who win government contracts in market competition. Despite the noticeable achievements in economic transformation in China, the promise of a well-established market system characterized by fair competition and effective regulation remains unfulfilled. What the Chinese government needs to do is not so much to work on the formal rules of competition but to combat against the unwritten codes in a seemingly competitive market. This is a challenging yet imperative task for China’s leadership in the years to come.

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