

## **Main Problems of Federal Contracy System of Russia**

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**Abstract:** The author reviews the current state of the public procurement mechanism in the Russian Federation operating under formation of the Federal Procurement System. The article offers a brief comparative description of the procurement systems of Russia and the US. The author identifies the main drawbacks in the procurement sector and analyses possibilities of eliminating the drawbacks. Suggests ways for resolution of conflicts.

**Key words:** Public procurement · Federal contract system · Selection of suppliers · Placing orders  
· Selection criteria

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### **INTRODUCTION**

The process of formation and operation of the public procurement system in the Russian Federation has been underway for quite a long time - from the enactment of the Law of the Russian Federation of 28.05.1992 "On supply of products and goods for state needs" till the effective date of the Federal Law# 44-FZ of 05.04.2013 "On the procurement system for goods, works and services to support state and municipal needs".

There is no doubt that during this period many faults of effective laws regulating the public procurement process were taken into account and analyzed. At the moment, mechanisms for elimination of such faults formed the basis for a new law on the Federal Procurement System. Nevertheless, a thorough analysis of the current procurement system of Russia gives rise to many questions, which is not surprising, since the history of the public procurement system in our country is quite short by the world standards.

To illustrate that, let us look at the history of the most developed and functional public procurement system of today - the procurement system of the USA. Active development of public procurement in the US started in the XX century. Nowadays, the budget funds that are being managed within the federal procurement system total USD 500 billion. Over 160,000 commercial organizations are involved in the FPS.

Almost 12.5% of the working age population of the US (about 17 million people) is employed in the public procurement sector[1].

However, although the US federal procurement system is one the most advanced and well-developed in the world, it is not entirely free of drawbacks. For instance, there is conflict between the strict regulation of all life cycle phases of a public order and insufficient independence of people who ensure fulfillment of contracts (contract officers). Therefore, the American FPS is still improving; new regulations are being adopted; new methods are being developed for conclusion and analysis of contracts and control of order fulfillment results.

In Russia, according to experts, the annual public procurement amounts to about 8 trillion Rubles, which is one fifth of the national GDP.

It should also be noted that from July 2012 to July 2013 over 2.3 public procurement procedures took place in Russia, their total value exceeding 6 trillion Rubles. More than 236,000 organizations placed their orders during that time[2].

Analysis of these facts shows that there are certain contradictions in the current procurement system of Russia: between the ever growing amount of the public procurement and the level of corruption in that sector, which remains high; between introduction of various forms of control and supervision of order fulfillment and the emerging new forms of legal abuse and violations

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during fulfillment of contracts. Actually, it is the presence of an independent threat to the economic security of the country [3]. We have identified the main issues that prevent elimination of these conflicts and analysed possible ways to address them.

## **MATERIALS AND METHODS**

**High Level of Corruption:** The main problem in the today's procurement system of Russia has been the high level of corruption. And this is not surprising - misuse of funds in public procurement including embezzlement and 'kick-backs' amount to 1 trillion Rubles per annum at least, which is about 15% of the annual public procurement. For example, the average 'kick back' in 2010 was 20 to 50% of the contract cost[4].

Moreover, the Head of the Chamber of Accounts Sergei Stepashin admitted when speaking at the State Duma in February 2013 that "hypothetically, we could speak of violations in this sector as exceeding one trillion Rubles per year"[5].

If we look at provisions of the Federal law on the contract system, there is a lot of questions arising as to opportunities for corruption activities in the public procurement. For instance, provisions of Article 37 do not bear scrutiny. The article stipulates that if the contract cost goes down more than 25% during an auction, the auction is to be declared void and the client has a right to buy the same goods by a non-competitive method - via a request for proposals. In reality, we could assume that if a supplier offers goods at a price that is too low, the amount of the kick-back that the client wants to get would be jeopardized. In such case, the client simply uses a non-competitive request for proposals instead of an auction.

On the whole, norms of the new law have a number of disputable and subjective elements, which have to be improved in amendments and additions. Otherwise, participants of the procurement process have ample opportunities for corruption. It should be noted that corruption in the public procurement sector is a very relevant issue today and results from numerous defects in the current contract law[6].

First steps in direction to solve this problem have already been taken. For instance, on June 2, Dmitry Medvedev signed the decree on liability of public officials for disruption of public contracts in the defense industry[7].

According to the said decree, the following shall be deemed a gross violation of terms and conditions of a defense contract: repeated administrative violation

stipulated by parts 1 and 2, Art. 14.55 of the Administrative Law; a breach of terms and conditions of a public contract that caused the Russian Federation losses amounting to at least 5% (but no less than 5 million Rubles) of the contract cost; a breach of terms and conditions of a public contract resulting in failure to complete the assignment under a defense contract. Any public official who commit such an offense is to be disqualified for up to three years.

**Imperfection of the Legal Base:** Another group of problems is a large number of gaps in the new law and conflicting norms. This results in different interpretations of the new regulations and procurement mechanisms by actors of the contract system[8].

For instance, the new law expands the range of supplier selection methods, but fails to indicate on what grounds a client is to choose the form of the bid procedure. Such freedom may give an advantage to certain categories of suppliers. If we look at one of the new procedures now allowed — a two-phase auction — specifically in terms of interactions between the client and the contractor, we may notice hidden opportunities for collusion[9].

Another important aspect is efficiency of public budget spending during procurement procedures, which is minimum spending with the best final outcome. Nevertheless, despite the importance of this factor in assessment of order completion efficiency, the law does not provide any penalty for improper completion of an order. This leaves clients and contractors opportunities for violations within the public procurement process. This flaw could be eliminated by adding norms to the Administrative Violations Code of the Russian Federation that concern liability of public officials for public budget spending violations committed when concluding contracts. In this case, measures should be developed that would allow assessment of the extent of guilt of a public official who committed offences.

The closed supplier selection methods provided for in Art. 84 of the Federal Law # 44-FZ also raise a number of questions. In this case, procurement information is to be sent to certain parties that meet requirements of the Federal Law. Obviously, this norm gives a client an opportunity to interpret those requirements to its own advantage.

**Selection of the Contractor:** There are also problems in what regards selection of supplier. Federal Law # 44-FZ provides for new supplier selection methods: A bid

procedure with limited participation, a two-phase bid procedure and a request for proposals. The new supplier selection methods were developed and introduced to fight multiple violations during selection of contractors for orders.

However, the most common method today is an electronic auction. This procedure was used under the Federal Law 94-FZ and was not changed by the new law. Despite all their obvious advantages – transparency, accessibility and increased competition – electronic auctions have a number of drawbacks: their being public and open attract dishonest and unskilled bidders and verifying qualification of an unknown supplier is difficult [10].

Federal Law # 44-FZ defines several bidder evaluation criteria and the main one is the price of the contract. Defining the opening price of a contract is a challenge, since the opening price is the basis for the cost of the order. Forecasting opening prices for years after the contract signing date is a vital issue as well. The issue of setting standard prices for products, works and services to be provided by a contractor is particularly relevant due to increased significance of planning in the procurement sector. Another difficulty is evaluation of two contractor selection criteria: qualification of bidders and qualitative characteristics or procurement object (order).

This aspect is getting the least attention in terms of ongoing studies and current know-how, while selection of contractors and the setting of the opening price are the backbone element for the award of a contract. There is no doubt that qualification of bidders should be evaluated based a number of generalized qualitative and quantitative factors, which are subsequently grouped and enable bidder qualification assessment.

The initial price of contract is determined based on a certain set of parameters since products to be supplied, works to be performed or services to be provided vary greatly. Due to significant differences between various products, works and services, the opening price should be determined by agency-level documents, but general recommendations on structure of costs and the extent to which they should be taken into account should be provided in state regulations associated with the Federal Law 44-FZ, which would become general national recommendations.

Lack of a clear mechanism for state and public control. Because of the high level of corruption in the public procurement sector, the control issue is of particular relevance, including both state and public control over all contract life cycle stages. Federal Law

#44-FZ provides for a large number of methods to evaluate efficiency of public procurement, one of those being public monitoring of compliance with procurement law [11].

However there are some issues with operation mechanism of the public control since it is unclear how procurement procedures will be selected for discussion.

The same also applies to public discussion of procurement. Article 20, Federal Law #44-FZ indicates that “the Government of the Russian Federation specifies where public discussions of procurement are mandatory and the procedure for such discussions”, without saying who is to participate in such discussions.

With regard to the state control over all contract life cycle stages, the RF Government has developed and approved the departmental control procedure for procurement of goods, works and services. Moreover, Chapter 5 of the Federal Law #44-FZ is dedicated to that issue [12].

Nevertheless, although law-makers did give a lot of attention on public procurement control, actions of supervisory authorities to be involved in audit procedures or where and how results of such audits are to be published were never specified and the appeal procedure for rulings of such authorities. All these aspects are to be addressed in the foreseeable future by developing and adopting new legal acts. Since the RF Government has recently issued a Decree defining the procedure for internal audit including public procurement audit [13].

Involvement of small businesses. At present, the share of small and medium-sized businesses in public procurement of Russia is no more than 2% [14].

**Compare:** 20% of all contracts in the US are awarded to small businesses, which provides for healthy growth of the economy and the maximum competition among market actors [15].

After Federal Law #44-FZ became effective, the need to increase the role of small and medium-sized businesses in the public procurement system has become especially relevant. Involvement of small and medium-sized businesses in bid procedures would lay the foundation for stability of the Russian economy and create all kinds of conditions that encourage business expansion. It is hard to underestimate the importance of participation of small and medium-sized businesses, since expansion of the circle of actors in the contract system leads to increased competition in that sector and therefore to better quality of products and services and faster development of the market in general. However, currently,

most orders are rather expensive and small companies cannot even provide a security for their bids since they do not have enough money on their accounts.

Nevertheless, according to experts, the current practice on the Russian market is as follows: contracts are awarded to major companies who then engage medium-sized and small companies as subcontractors. Therefore, we should discuss the entire operation of the public procurement system rather than just the involvement of small companies [16].

One solution for that problem, if only a partial one, would be to split orders into smaller orders that small and medium-sized companies could handle, i.e. to differentiate public procurement by various criteria. This solution would make it possible for small and medium-sized businesses to become proper actors of the contract system and participate in tenders on equal ground with huge holding companies.

Procurement of goods from domestic suppliers has been a particularly relevant issue of late. The quality of services and goods provided by foreign suppliers is often much higher than that of Russian goods and services and if the quality is the same, foreign goods and services are simply cheaper. Obviously, foreign suppliers are preferred in such situations.

Lack of competent staff. Besides, the current shortage of competent specialists is a most serious problem. New provisions of the contract system law that became effective earlier this year complicate operations in the public procurement sector for clients as well as contractors. Administration of the said law is difficult since clients and contractors have to be familiar with many legal acts that are linked with the Law and govern its provisions. Even a training course aimed to study Federal Law 44 would not guarantee a competent and correct work in the public procurement sector, because that would require practice. Hiring competent specialists is important because correct application of the law gives one a competitive advantage in a bid procedure.

In addition, complexity of the new contract system promotes professional development in that sector, since only a specialist can cope with the many regulations in the public procurement sector. Moreover, public procurement rules also apply to small state-financed organizations that may not even have such specialists. In such cases, there is a risk of procurement disruption and violations, which not only leads to higher penalties but also affect the operating mechanism of the entire contract system.

It is easy to assume that the new contract system should be based on the professionalism principle. Individuals who are involved in public procurement processes always have to improve themselves. Public procurement actors should possess a vast knowledge of legal and economic aspects and have a general understanding of establishment of the opening price of a contract, the placement and completion of the order and analysis of the results.

## RESULTS

**High Level of Corruption:** The problem of corruption should be addressed using both national and international experience and based on the actual state of the Russian market. First of all, the applicable law has to be changed since multiple gaps in the laws and regulations provide dishonest participants of the procurement process opportunities for multiple violations in that area. Another difficulty is that for rational performance of the procurement regulation mechanism, laws have to be harmonized and conflicts between various laws should be eliminated. This would only be possible if people with practical experience developed the norms so that the resulting legal norms would not be "far from reality". There is no doubt that in addition to all that, steps should be taken to make clients as well as contractors more responsible when completing contracts and to develop a higher level of legal awareness in future specialists who study the Law 44-FZ.

We believe that another way to address the corruption problem would be to increase the transparency of the procurement system. We should also mention the implementation of the state policy aimed to increase the role of information systems in the procurement sector, as well as massive introduction of electronic document management into activities of actors of the contract system as one of the methods to increase their efficiency.

**Imperfection of the Legal Base:** To prevent such incidents today is extremely difficult since there are no legal acts that provide a clear procedure for supervisory authorities for such situations. The solution for this problem as mentioned above could be involvement of people with practical experience in development and improvement of norms that regulate the contract support process at all stages of the contract life cycle. Moreover, the approach to additions to regulations that govern the federal contract system should be comprehensive in order

to provide detailed rules for actors of the contract system and clear directions and methods for their operations. However, it should be noted as well that improvement of the legislation will take years before regulation of the federal contract system of Russian reaches an acceptable level.

**Selection of the Contractor:** In our view, the opening price issue could be resolved if there were a library of standard contracts. Such libraries are widely used in many developed countries of the world. A list of the most common types of contracts would make order completion much easier, since such a list would not only provide an approximate price of a contract, but also describe specifics of all activities that such order completion involves.

On the other hand, evaluation of bidder's qualification is one of the most serious issues, since qualification is a qualitative parameter depending on a wide range of factors. However, we believe that this problem could be addressed by defining a number of indicators, using which qualification of a bidder could be assessed. Experts could be engaged to define such indicators and then the selected ones could be ranked according to their impact on the qualification level of a potential contractor.

Lack of a clear mechanism for state and public control. There should be a clear division of powers of review bodies and supervisory authorities and a definition of the main goal of their work. Although the new law has an entire chapter covering control and supervision in the procurement sector, new legal acts are likely to be issued to regulate activities of particular authorities. This seems to be the only way to resolve this problem.

Moreover, to provide for proper public control, rights of individuals, organizations and legal entities have to be expanded to make it possible for them to suggest improvements in procurement law and provide public monitoring and assessment of contract fulfillment progress. Such rights should be detailed in regulations so that suggestions and assessments by the public would be really registered and reviewed rather than remain a pure formality. The processing of such suggestions could be the key to improvement of the contract system as it is developing in our country.

**Involvement of Small Businesses:** The problem is that Russian businesses are unable to compete with foreign companies and eventually get left behind. Moreover, all

financial resources leave Russia, which prevents development of Russian companies. This brings a number of negative effects such as unemployment, lack of funds for modernization of production facilities, low investment attractiveness, etc.

Being aware of the scale of negative prospects for development of domestic businesses, the RF Government comes up with various solutions. For instance, the Ministry of Industry and Commerce has suggested reducing the share of public procurement of imports. The list of goods to be procured from Russian suppliers or the Customs Union countries is expected by the 1<sup>st</sup> of October.

The implementation mechanism is that organizations and institutions that purchase goods under Federal Law # 44-FZ will have to prepare time schedules for the transition to domestic suppliers. The goal of this intervention is to limit the share of imported goods procured within the public procurement system. According to the plan, the share of domestic products in civil industries is to reach 80% by 2017 [17].

The mandatory requirement with regard to realization of this decision is to ensure competition, which means that similar goods/services of adequate quality have to be available from 2-3 suppliers.

Lack of competent staff. This problem could be addressed through establishment of an education and capacity building system and one should not forget that both theoretical knowledge and opportunities for gaining practical experience are important. Obviously, state standards for public procurement should be based on the actual market conditions and the contract system of Russia.

For example, in the USA, there are clear qualification requirements for all specialists employed in the public procurement sector, as well as job guidelines for their respective positions. The status of such a specialist (contract officer) is especially prestigious, since a civil servant who is in charge of all stages of a particular order is normally highly professional [18].

Naturally, such a system should be supervised by the government since the quality of training services provided to potential clients and contractors affects the state of the national economy in the foreseeable future. Besides, the procurement process for small clients could be simplified, which means a transition to procurement from a sole supplier, but there are some corruption risks in such solutions (collusions, 'kick-backs', etc.)

## DISCUSSION

All the issues identified in this article could be divided into two groups: high level of corruption in the public procurement sector and imperfect laws and regulations governing the federal contract system. The drawbacks discussed above are certainly natural for a developing contract system like the Russian system and they could be overcome. Nevertheless, good results would only be possible with a correct and comprehensive approach to improvement of the public procurement system, which should be adopted for a long period of time. Of course, it can be seen emerging positive things, as many experts agree that the use of new methods and tools will save about 1 trillion rubles in procurement [19].

We believe that the solutions set forth above that are aimed to fight corruption in the public procurement sector and make contract system regulations more detailed and flexible, are locally balanced. Today the public procurement system is trying to meet the short-term needs, but at the national level one has to think for decades ahead. Adoption of new legal acts may slow down the procurement process now due to complexity and comprehensive nature of new procedures, but that would surely bring benefits in the future. The scale of changes will depend on rationality of the "law-makers" approach to analyzing current problems and the resulting solutions.

## CONCLUSION

Within any system of economic relations, public procurement plays a significant role in meeting the needs of the state. The presence of a coherent mechanism for the implementation of public procurement is a guarantee of the quality of work and services and gives impetus to the development of the economy in the country.

Russian public procurement system is currently going through a reformation and transformation. Contradictions, we have described above allow us to conclude that the Russian federal contract system to date, there are certain problems that can be eliminated, including through the use of foreign experience. Appeal to the practice of public procurement systems of developed countries in the world allows you to extract all of its very positive and functional solutions.

Sure, isolation of foreign experience has a positive impact on the reform of the contract system in Russia. Nevertheless, it is necessary to understand that most of

the problems described in this article, is a consequence of high-level corruption and inadequate development of the regulatory framework. These two closely interrelated problems require urgent solutions and control by the state. Building a well-regulated and functional contract system is not possible in the presence of these obstacles. Further work is seen by us in the design and analysis tools and techniques permit described in this article contradictions.

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