Observations on the Draft Federal Law on Public (Municipal) Social Contract for Provision of Public (Municipal) Services in Social Sphere

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At the request of Ministry of Finance, the World Bank has reviewed the draft *Federal Law on Public (Municipal) Social Contract for Provision of Public (Municipal) Services in Social Sphere and Introduction of Amendments to Individual Legislative Acts of the Russian Federation* (as of March 2017) (the "draft Law"). We are providing below some general observations on this draft Law based on the World Bank's own procurement rules and other international legal instruments and our experience supporting the contracting of certain social services under World Bank projects world-wide. In addition, we are attaching a document containing more detailed comments on specific provisions of the draft Law for the Government's consideration.

We would like to express at the outset our support for the development of this regulation, which aims at providing transparent processes and predictable outcomes in the contracting of social services at the federal, regional and municipal levels. The World Bank generally recommends that public procurement laws have application to all public procurement, including within their scope all sectors and types of public procurement funded from the public budget. Nevertheless, we also recognize that certain procurements may be deemed to require specific treatment due to their subject matter or other considerations. With respect to the procurement of social services, in particular, the World Bank recognizes that the Government has specific objectives in terms of promoting accessibility and quality in the provision of these services and that these objectives may require specific provisions or approaches intended to facilitate the contracting of qualified external providers.

Also as a preliminary observation, we would like to note that we have conducted our review based on a translation of the draft Law and that our comments (and particularly those detailed ones in the attached document) may reflect different levels of misunderstanding due to this translation.

Subject to that caveat, we believe the draft Law would benefit from clearer and additional definitions as well as ensuring defined terminology is used precisely and consistently. It is understood that many cited concepts and terms would already be defined and described elsewhere, including in the Federal Contracting Law, but it is important to provide references to these relevant definitions in related legislation (and to provide references in those other regulations to the current Law). Our detailed comments note some of these areas that would appear to be a benefit from greater precision. And as a further drafting/editorial observation, the draft Law appears to contain substantial overlap in subject matter, for example, between Chapters 1 and 2, and would benefit from reorganization and consolidation.

Objectives of the Law. The draft Law does not explicitly identify the overarching principles or objectives which would apply to the contracting of service providers under the draft Law or specifically to competitive selection of service providers. It would be important to state these objectives either directly or by reference to other legislation (the Federal Contracting Law, the applicable federal laws on Public-Private (Municipal-Private) Partnership ("PPP") and Concession Agreements, or otherwise). They would include not only well-recognized principles of public procurement – "value for money" might be one such principle, reflecting the Law's emphasis on quality and other effectiveness considerations over lowest cost alone -- but also other objectives of the Government in implementing the draft Law.

Scope of application. While the justification for a free-standing law on contracting of social services can be recognized, it is critical to ensure this Law itself is clear in scope and that this scope is appropriate to achieve the Government's objectives. The draft Law spans an apparently wide range of social services, apparently described by reference to the "separate section of the basic (sectoral) lists of public (municipal) services and works compiled in accordance with the budget laws of the Russian Federation" and further identified in Chapter 4, Concluding Provisions. It would be advisable to ensure that this provision clearly defines both included and excluded services so as to avoid the need for interpretation. We have detailed some questions in this regard, stemming from the statement in Article 1 of Chapter 1.

It should also be considered whether the social services covered under the draft Law are sufficiently aligned in terms of common features such that the Government's objectives can be met based on the relatively "one size fits all" approach presented. Although specific provisions and approaches are left to secondary procedures, it is not clear that three contracting methods based on a single competitive selection method can cover the whole range of externally provided social services described here. We recommend that the Law contain the main requirements relating to the selection process, but we also believe there may be a benefit to expanding on the range of procedures and arrangements in the draft Law to meet any service-specific requirements or conditions across this spectrum.

As a general rule, the benefits of competitive procurement over direct contracting are well-recognized. However, this rule presumes that procurement methods can be developed that stimulate genuine competition among firms in the same discipline and with similar mandates, cost structures, business models, capabilities and resources. In this respect, the characteristics of the local market and of the services to be provided are an essential consideration, and the procurement strategy should retain flexibility to permit a range of procurement methods that are fit-for-purpose and focused on value-for-money considerations.

Selection Methods. The draft Law contemplates that where public/municipal institutions will provide social services, such services will be retained directly through an "assignment" by the authorized body to these institutions. External service providers, by contrast, will be selected through a competitive procedure or by the service consumer directly from a register.

In general, the draft Law maintains a dichotomy between "assignment" and competitive selection which is relatively clear, and identifies the competitive procedures for the selection of external service providers. However, the draft Law does not clearly explain whether there are circumstances under which public/municipal institutions can compete with external service providers. And equally importantly, the draft Law does not define how decisions shall be made on choice of service provider or specific selection method (in the case of external service providers). The draft Law provides for competitive selection of external service providers by the authorized body under the applicable laws on PPPs/concession agreements or following an auction procedure, or a "selection" by the "service consumer" directly from a register of service providers. However, it does not provide the grounds or conditions by reference to which an authorized body must justify its decision to provide the services directly or through an external provider, and if through an external provider then on what basis. These are apparent omissions that it would be important to address.

With respect to PPPs/concessions, the World Bank has observed that such partnerships may be identified as a commercially viable option for social service delivery based on market analysis of potential service providers. However, the client's capacity to manage the PPP/concession agreement

over a long time period and to sustain the PPP/concession objectives are important criteria in structuring the PPP/concession agreement. The process of selecting the contractor/concessionaire should be competitive, unless the local market conditions or nature of the services dictate a different approach.

With respect to auctions, there are no detailed provisions on this auction process, but we understand it may refer to an electronic reverse auction procedure as provided for in the Federal Contracting Law. The World Bank describes electronic reverse auctions in our July 2016 Procurement Regulations and recognizes that their use can provide benefits with respect to enhanced transparency, increased competition and reduced fraud and corruption. However, the World Bank recommends that such auctions are best used for procurement of off-the-shelf, readily available goods and small-value, standard works, where the purchaser's requirements can be adequately specified and there is already adequate competition. We are not in a position to be able to confirm that such a procedure is best suited to address the Government's objectives in contracting social services, particularly where services may not be standardized, markets may not be developed, quality considerations play an important role, and there is a risk that cost will drive quality. To be clear, we recognize that there may be substantial experience in Russia using such method in contracting social services of this kind, but we believe it is important to consider that this method may not be best suited for procuring all social services in all markets.

As a related comment, the draft Law requires reliance on standard costs and formula to establish a starting price, which we understood would be used in the context of an electronic reverse auction as the ceiling price. While controlling costs may be a very important consideration, development of standard costs and formula, and in particular establishment of starting prices in the context of social services may be seen as putting an undue burden on the government, which may not be well-placed to be able to come up with these costs and formula applicable to a range of different markets. Additionally, reliance on such standard costs and starting prices may not serve in every case the Government's purpose in promoting open competition and may impact on quality. This is a consideration that should be taken into account in designating the auction as not only the default but the only method for competitive selection of service providers under the Law.

The draft Law separately provides for a procedure for selection of an external service provider by service consumers directly from a register, through use of certificates. Again, there are no detailed provisions, but the draft Law appears to focus on this downstream process between the service provider and service consumer, without explaining when a register might be used or the process for inclusion of service providers on such register.

As a general matter, it would be important for the Law to enable the systematic prequalification and/or registration of potential service providers on a continual basis. Such a mechanism, if transparent and easily accessible, would promote the privatization of social services very effectively, encouraging new and emerging firms in the various social service sectors to find a point of entry into the evolving market. Prequalification specific to a particular case may be most appropriate for non-routine or infrequent services, to make sure participants have the required technical, financial and managerial capabilities for the particular procurement in question.

Conversely, for frequent and commonly used services, an on-line registration process may be more appropriate. It is important that there are procedures in place to ensure that any such register is

current and up-to-date, and that the inclusion process is open, fair and transparent, with clear rules and mechanisms to review applications based on service-specific criteria intended to ensure that the service providers have the qualifications to be able to deliver the services in accordance with quality and other standards. Preferably, the Government should designate a single lead agency or agencies in each social service sector to promote, build, manage and maintain this nationwide online registration system. The system would then provide instant accessibility to procuring authorities at the federal, regional and municipal levels. A complaints handling mechanism, overseen by an independent third party, would help resolve any disputes over rejections and disqualifications of applicants for registration and safeguard its transparency.

The draft Law appears to envision a register and an auction as "either/or" scenarios. However, a well-maintained register could be used with other specific criteria as the first stage to an auction or other competitive process.

Additionally, although the draft Law does not describe prequalification or registration in such terms, we recommend that consideration be given to using framework arrangements for the procurement of social services, with the responsible authority (acting on its own behalf or also on behalf of other authorities) conducting a competitive procedure to enter into framework agreements. These framework agreements would establish the minimum terms and conditions for the provision of services by suitably qualified external providers to procuring federal, regional or municipal authorities and/or to consumers. It is widely recognized that framework agreements can provide multiple benefits in terms of process efficiencies – better quality submissions, increased understanding, confidence in system, enhanced transparency, more effective oversight, economies of scale, higher uniformity and standardization, lower transaction costs. Such an agreement is ideally suited for the delivery of continuous or staggered services in a particular social service sector at one or more location, and would ensure that the service providers are legally bound to certain terms and conditions in relation to the services they may provide, including quality indicators, fees, pricing mechanisms, etc. These terms and conditions could be broadly or narrowly defined based on the specificities of the service to be provided. This arrangement should be open to new entrants either on an ongoing basis or at defined points in time.

The invitation to apply for a framework agreement can be direct or openly advertised, depending on the circumstances. It would include (i) a well-defined description of the services that the framework agreement would cover; (ii) the estimated scope, volume and frequency of services for which so-called "call off" contracts are expected to be placed; (iii) the qualification and evaluation criteria for applicants who wish to be included in the panel of providers; and (iv) the initial duration of the framework agreement, with options for extension. A draft call-off contract, stating the terms and conditions of service delivery, payments, performance measurement, etc. may also be provided; but the invitation would state that qualified firms have no guarantee of any downstream contract. The "call off" itself could be accomplished through an auction or other competitive process.

Finally, while the draft Law appropriately recognizes the importance of competition in selecting external service providers, it should be considered that there may be cases – due to the market or otherwise -- where there is a justification for direct selection of an external service provider. The draft Law does not appear to provide any avenue to accomplish this result, but appears to rely on public (municipal) assignment to public (municipal) institutions in the event of a failed competitive selection process.

Rules on participation. The draft Law sets forth a number of mandatory grounds for exclusion from the selection process for reasons not linked directly to qualification. It is understood that these exclusions apply to competitively selected service providers, including those selected by service consumers from the register. However, the draft Law is less clear in relation to the evaluation of the qualifications of service providers. The role of licensing or accreditation procedures/licensing and accreditation bodies seems important here at least with respect to some services, not only for purposes of evaluating qualifications but also for contract monitoring. However, it does not seem to be explicitly mentioned in the draft Law. Additionally, while the Law contains a provision on conflict of interest, this provision is narrowly drafted and would benefit from review to ensure it covers relevant conflicts of interest that could impact on competition, including in the case of participation of service providers affiliated to the procuring entity and in any scenario where public (municipal) institutions might be considered under a process in which external service providers might participate.

Contract provisions. The draft Law requires that the Government develop a model form of contract, although it not clear the extent to which other standard forms will also be developed at the regional and municipal levels or whether, at those levels, the draft Law is referring to special conditions added to this model form. We believe such model contracts serve an important purpose, but consider that there may be a need to develop different models, based on the specific social service and other variables, including specific market conditions. In addition, it seems important that model contract forms allow for customization beyond quality and scope indicators. Risk allocation between the parties will shift based on specific circumstances, contract duration and other key provisions will vary, and the contracts should allow for amendments including extensions or options which give the authorized body the ability to respond to new requirements and circumstances.

The objectives of the Law will not be accomplished without particular consideration for the actual markets that are targeted – or even being created -- by the outsourcing of the social services, and it is important that the tendering documents and contracts include appropriate incentives to help these markets develop.

In the World Bank experience, output- and performance-based contracts are appropriate for service delivery where the services lend themselves to being clearly specified and readily measurable with regard to quantity and quality, with service levels established by the government and maintained by the service providers in order to satisfy the needs of the beneficiaries. Prequalified service providers compete for such contracts based on lump-sum prices and are compensated strictly based on verifiable outputs and outcomes. In order to maintain service levels consistently, service providers must have the necessary human resources with the required technical skills, and also have the managerial qualifications and financial capabilities to be capable of assuming the considerable risk of being solely dependent on output-based compensation under demand-driven circumstances.

Monitoring and evaluation. The draft Law properly emphasizes the importance of clear quality standards and establishes the foundation for contracts with well-defined requirements, precise definition of activities, and the need for certainty on payment terms and conditions. However, the draft Law does not elaborate on contract management measures to ensure that the service provider complies with quality and other standards and is accountable for this work. In particular, the draft Law requires that the contracts include “indicators of the scope and quality or scope” of services but it is not clear how these indicators are developed, including whether they are specific and relevant to the services

under the contract. It is equally important that such indicators be measurable and attributable, based on actual data, so that they can used to conduct an objective assessment of performance under the contract.

As noted in the detailed comments, the provisions for contract termination may not give the authorized body sufficient “ammunition” to respond to material breaches of quality standards or other performance defaults. By contrast, the monitoring and evaluation system appears more focused on the financial performance, although the provision for independent monitoring by citizens and other third parties represents an important mechanism to assess compliance with the quality and scope indicators in the contract. The World Bank’s experience in performance-based outsourcing of social services has highlighted the importance of appropriate third-party verification of the contractual indicators and results.