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# **Bypassing public procurement regulation: a study of rationality in local decision making**

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## **Abstract**

Using private contractors through procurement is common in most public sector areas. Despite the benefits of procurement, officials are sometimes tempted to circumvent procurement regulations. The aim of this article is to examine the strategies used by local governmental decision makers to bypass procurement regulations and to analyze the rationality underlying these officials' actions. Interviews, court documents, municipal documents, and newspaper articles describing the actions of Swedish municipal officials concerning special transport service (STS) procurements were collected and analyzed. In a case in which rural municipalities lost regular taxi services after STS procurement, we demonstrate how decisions were driven by pressure from the public and local interest groups, making municipal officials deviate from procurement regulations in striving to secure the existence of regular taxi services. One outcome was that local businesses were given preferential treatment, violating regulations and reducing economic efficiency.

**Keywords:** decision making, procurement, local government, regulation, transport

## Introduction

The use of private contractors engaged through procurement is common in most public sector areas (Armstrong & Sappington 2006). One major goal of public procurement through competitive tendering is to increase public sector (cost) efficiency, reducing costs while keeping quality constant or getting higher-quality service at the same cost as before<sup>1</sup>. The laws and regulations pertaining to public service procurement are designed to ensure that the objective – increased efficiency – is attained. Although research (e.g. Alexandersson et al. 1998; Hoekman 1998; Hensher & Wallis 2005; Hensher & Stanley 2008) has demonstrated that costs usually fall by 20–30 percent as public procurement is introduced, the process does entail some problems.

One problem is that government officials are tempted to give preferential treatment to special interests. Erlingsson et al. (2008) argues in a recent study from Sweden that corruption-related actions are most common in connection with procurement situations. These actions usually take the form of giving local firms preferential treatment to foreign firms or firms from elsewhere in the country (see also Hoekman & Mavroidis 1997). In this context, Kelleher and Yackee (2009) showed that contracting provides new opportunities for special interests to influence policymaking.

As will be demonstrated here, local officials are tempted to take measures, some straightforwardly illegal, others on the borderline between legal and illegal, to circumvent procurement regulations, often resulting in local firms being awarded contracts. The aim of the article is to examine the strategies used by local governmental decision makers to bypass procurement regulations and to analyze the rationality underlying their actions.

Previous studies have demonstrated that there are problems with the implementation of procurement regulations and have discussed the effects of such regulations at local and national levels (e.g. Boyne 1998). It has also been demonstrated that decision makers favor local or domestic firms (e.g. Martin et al. 1999). A substantial amount of cases where the local

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<sup>1</sup> Unfortunately, public officials and researchers often confuse increased efficiency with cost reduction, without taking quality into consideration (see discussion in Hensher & Wallis 2005).

government has deviated from (or broken) procurement regulations or competition laws can be found in many public undertakings, such as child and elder care, food preparation (e.g. school lunches), and construction (Konkurrensverket 2007, 2009, 2011). The present article highlights the complexity underlying decisions to deviate from procurement regulations. It will demonstrate that deviation from procurement directives is often not due to mistakes or lack of knowledge, but reflects intentional strategies and can therefore be seen as the product of rational decisions and actions. From the legislators' point of view, these actions undermine the intent of the law, and the public in these municipalities will have to pay more for services than otherwise. The article also suggests that regulations stressing economic efficiency alone, to the exclusion of other values, are not infrequently regarded by local governmental officials as impeding their efforts to serve what they see as their communities' public interest, even if it is not economically efficient to do so. Studies of these practices are therefore of general interest both in terms of the implementation of laws and regulations and from an accountability point of view.

The following section briefly introduces the institutional setting of public transport procurement in Sweden, after which the methods and materials are presented. In the theoretical section, we take the potential tension between central and local levels of government in terms of their different interests as a point of departure. This perspective is then used to analyze the empirical material. An in-depth analysis of a case illustrates the rationality underlying local decisions. The results and implications of this analysis are then presented in the concluding sections.

### **The Swedish context**

Although our results will be useful for understanding other areas of decision making, this article specifically addresses the issue via a Swedish case concerning the procurement of taxis for special transport services. An introduction to the Swedish context is therefore in order.

Sweden is a country with large sparsely populated areas, and approximately 18 percent of Sweden's nine million citizens live in rural or very sparsely populated areas (Marell & Westin 2002; Statistics Sweden 2010). Sweden is a unitary state with both central and local

governments. The country is divided into 21 counties, each with its own elected county council; each county includes a varying number of local authorities called municipalities.

The two most common means of public transport used in Sweden are buses and trains, which are primarily used in the provision of regular public transport. Taxis are also used in public transport, usually for school transport and as special transport for disabled people unable to use regular public transport (Marell & Westin 2002). Here, we refer to this service as the special transport service (STS).

Responsibility for public transport in each county rests jointly with the municipalities and the county councils. Public transport contracts are generally awarded by public procurement through competitive tendering. The responsibility for procuring regular public transport is usually delegated to a county's public transport authority (PTA). The responsibility for special and school transport services is handled differently in different municipalities (Alexandersson et al. 1998): in many, responsibility for procuring these services is delegated to the PTA, while other municipalities handle the procurement themselves. The transport service is generally supplied by private companies under contract to the authorities (Alexandersson et al. 1998)<sup>2</sup>.

Before 1990, the taxi market in Sweden was regulated and the number of firms allowed to operate in a specific area was limited. Today the market is deregulated and anyone with a taxi permit is allowed to operate wherever he or she wants. Obtaining the contract for special services and school transport is often crucial for the survival of local firms active in rural areas. In these areas, more than 80 percent of taxi trips are publicly subsidized (Marell & Westin 2002) and the private market for taxis, in terms of demand, is extremely limited. Income obtained from winning procurement contracts is an important source of revenue for taxi firms outside Sweden's larger cities. In fact, especially in rural areas, taxi companies might have difficulties surviving solely on privately paid trips – if they do not win a public transport procurement, they might leave the market or decide not to enter it at all (Marell & Westin 2002).

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<sup>2</sup> Jansson and Wallin (1991) describe the organization of Swedish public transport in greater detail.

## **Method**

The empirical findings presented concern actions taken by local authorities to circumvent current procurement regulations, exemplified by STS procurement.

First, we had to identify municipalities where procurement regulations have been sidestepped by local authorities. Because such actions are not always reported to the court or officially documented, identifying them requires the use of multiple methods. We systematically analyzed newspaper articles selected using various keywords. We limited the reviewed articles to ones treating processes for procuring local public transport services (e.g. bus, train, ferry, disability transport, and school transport) from 2002 to 2009<sup>3</sup>. We identified several municipalities where we suspected procurement regulations may have been violated or circumvented. Many such cases turned out to concern STS procurement in rural areas, prompting us to focus on such cases<sup>4</sup>.

We also systematically analyzed cases reported to Swedish county courts and identified cases in which violations were suspected. When conducting interviews for other projects, we also obtained information from public officials on their and other municipalities' efforts to bypass procurement regulations.

After identifying the municipalities, we analyzed four closely. We chose them on the basis of similarities, in that they all included local authorities taking actions to circumvent procurement regulations when procuring STS in rural areas, though they differed in the extent to which legal procurement boundaries were stretched.

Our next step was to identify the actions taken in each case. To do this, we extensively reviewed the events based on public documents (e.g. court material and board protocols from

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<sup>3</sup> This study comprised part of a larger project concerning the effects of public transport procurement processes on Swedish local administration.

<sup>4</sup> Although focusing on STS procurement, the findings will be of general relevance because such circumventions frequently occur in other policy areas (e.g. Andersson 2002; Konkurrensverket 2009).

municipalities and other public agencies), interviews, and newspaper articles. The public documents were used to grasp the content of the cases and in some sense identify actor motives. In some cases, these documents were not the best source of information; for example, when an actor took an action that possibly violated procurement regulations, but the action was not reported to the courts or recorded in any municipal record. To capture these violations and better understand the reasons for them, we interviewed leading politicians and public servants in the municipalities and analyzed local newspaper articles dealing with the specific cases. In the interviews, we asked the respondents how they conducted public procurements, reasons for not delegating the procurement process, challenges met when conducting procurement, and so forth.

When analyzing the cases, we found many similarities in motives for trying to bypass procurement regulations. In several instances, the fear of losing regular taxi services due to the outcome of STS procurement was used to justify giving preferential treatment to local firms in procurement processes. Such bypassing of procurement regulations occurred before, or in the early stages of, the procurement process. We have chosen to present in detail a case in which STS procurement did result in the loss of regular taxi services, and the actions taken as a reaction to this, because such cases can be seen as prompting deviations from procurement regulations in other municipalities<sup>5</sup>. The case displays deviations from regulations in an attempt to recover private taxi services lost due to the outcome of STS procurement.

## **Theoretical point of departure**

The main tool of the central government for promoting the use of public procurement is passing laws that demand the local level authorities to use competitive tendering when procuring goods and services. The policymaking by the local government is subject to central government regulations, but at the same time the central government's ability and possibility to realize its own goals is dependent on the cooperation of the local government (Hansen 2005). This means that the local government has to undertake tasks that are based on the

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<sup>5</sup> This is not to say that this is the actual or the sole reason for giving preferential treatment to local firms, but it is cited as a reason for bypassing procurement regulations.

central's government orders/decisions where the central and local goals and interests<sup>6</sup> are converging as well as tasks where central and local interests/preferences do not coincide. In addition to the tasks delegated by central government, local authorities have the responsibility to take initiatives on matters of local interest (Pierre 1994; Hansen 2005).

When studying different governmental levels it should therefore be pointed out that there might be cases where the interests of central and local levels of government are in conflict. The central level is (or should be) acting in the interest of society as a whole (i.e. in this case all individuals<sup>7</sup>) whereas the local government officials are promoting the goals of the local community (Lane 2005). To understand the actions of local officials, we have taken as the point of origin that actors are behaving rationally and explanations of their behavior must therefore be found in their interests and preferences<sup>8</sup>.

### ***Central government level interests: promoting competitive tendering***

As seen in the directives and regulations concerning procurement (e.g. The Swedish Public Procurement Act 2007: 1091)<sup>9</sup> the interest of the central government is that a Rationality in local decision making public entity should procure public services through competitive tendering (the usual alternative being to supply the service itself) in order to increase

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<sup>6</sup> The term "interests" should be interpreted in a broad sense, including more than financial or material interests, and reflecting preferences, values, and priorities.

<sup>7</sup> In applied analysis, *society* is often taken to mean the *nation*, but the only non-arbitrary definition is probably all individuals in the entire world.

<sup>8</sup> Using a term such as "rationality" is bound to raise questions as to what, specifically, is meant by it. In this context, we refer to rationality and rational behavior as taking the actions that, given the information available, one thinks constitute the best way of attaining one's goals. From a methodological point of view, assuming an underlying rationality (in our sense) can be seen as being generous in interpreting observed behavior. To assume people are behaving irrationally is to assume that they are taking actions they think will not help them attain their objectives and that they therefore have no reason for their actions – such an assumption would be ungenerous (e.g. Davidson 1984; Grimen & Gilje 2007).

<sup>9</sup>Sweden has incorporated the European legislation of procurement into national law and the courts are to take European Union (EU) regulations into account when issuing verdicts. (See Larsson and Bäck [2008] for an introduction to the Swedish judiciary system.) In Sweden, the main legislation pertaining to procurement is found in two different directives (SFS 2007:1092 and SFS 2007:1091) depending on what service or goods are to be purchased. This means that several legislative acts are relevant when procuring goods and services. We have chosen to describe the overall principles in the procurement regulation. These components are found in all acts.

efficiency; that is, obtain higher quality at the same cost or retain the same level of quality at a lower cost<sup>10</sup>.

Why is competitive tendering thought to increase efficiency? Procurement through competition is thought to shift operational decisions from bureaucrats to the private firms competing for the contracts. To win contracts, the firms cannot let themselves be inefficient because then someone else would be awarded the contract. For this process to work it requires, of course, that there be actual competition<sup>11</sup> for the contracts, that quality can be specified and monitored, and that the contracts be awarded to the most efficient firms. It also requires that the basis on which contracts are awarded be stated publicly, thereby opening the process to external control<sup>12</sup> (Boyne 1998; Martin et al. 1999).

If the objectives of procurement legislation are to be fulfilled – that is, for policy to be in accordance with the central government – five principles must be upheld by the procuring entity.<sup>13</sup> These are: (i) non-discrimination based on nationalism or regionalism (i.e. competing firms should not be given preferential treatment on the basis that they are national or local); (ii) equal treatment (i.e. all firms and their bids should be judged on the same merits); (iii) transparency, openness, and predictability in the procurement process; (iv) the proportionality principle – that the procurement requirements must be naturally related to the service being procured (i.e. the requirements must not be unrealistic or unnecessary); and (v) mutual recognition (The Swedish Public Procurement Act 2007: 1091).

### ***Local government values***

The local government in Scandinavian countries is part of a unitary state but it also possesses local self-government rights. The values legitimizing local self-government can be divided into three categories: (i) autonomy, (ii) democracy (or participation), and (iii) efficiency (Rose

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<sup>10</sup> An argument for why it is justifiable for some services to be provided by the public (in-house or through procurement) can be found in, for example, Rosen (2002) and Gramlich (1990).

<sup>11</sup> Or at least a threat of competition if costs rise too high.

<sup>12</sup> Several arguments can be made concerning these perspectives on procurement; in this section, however, the focus is on explaining the prevalent legislator's perspective. Such objections will be discussed later in the article.

<sup>13</sup> Because Swedish legislation incorporates EU regulations, these principles also comprise the foundations of European procurement law.

2005). Actions taken at the local government level could be analyzed in relation to these values in order to determine which value is the more dominant driving force behind them.

The local government is a vehicle for the implementation of public programs of the welfare state but it also has the right to take initiatives on purely local issues (Kjellberg 1995). In addition to autonomy, local self-government is also motivated by democratic participation. The democratic value in local government implies that active participation of the citizens in local affairs is a goal in itself, because it opens up the possibility for citizens to influence the decisions taken by the local officials. Participation is also an instrument for strengthening democracy in society at large, as citizens learn about public issues as they take part in local initiatives. It also contributes to a feeling of solidarity with the community and a sense of responsiveness to its members. The efficiency value expresses the view that local bodies are best suited to handle the needs and requirements of the community as well as the production of public services due to better knowledge of the local context (Kjellberg 1995). It is important to stress that these categories of values represent values between which a line is sometimes difficult to draw. Decisions taken at the local level can be motivated by one or all of these values and sometimes they can be in conflict. They also compete with other interests that may challenge them (Kjellberg 1995) (e.g. demands from the central government to use public procurement through competitive tendering). However, they can be used to understand which kinds of values are dominant when specific actions are taken at the local level.

### **Could deviation from the procurement rules be optimal?**

There are examples of when a local government deviates from procurement regulations, so it would be of interest to determine whether there are instances in which such actions might be optimal in terms of economic efficiency (i.e. obtaining the best possible service at a given cost). If decision makers deviate from procurement principles for such reasons, they are in violation of the spirit of the law, but are actually increasing efficiency.

Therefore, actions taken for such reasons are desirable in terms of economic theory and could be seen as motivated by the efficiency value of local self-government, despite the deviation from the procurement principles. Such instances typically concern principles (i) and (ii). First,

consider the case when the number of competing firms is small. If there is only one outside bidder with costs well below those of local firms, it has the incentive to enter a bid just below the expected bids of local firms to secure the contract and still make a substantial profit. In such a case, giving local firms a discount when bids are compared (violating the first principle) would force outside bidders to make lower bids, closer to their actual costs, thereby saving local taxpayer money. Note that the discount must be known in advance and that, if the strategy succeeds, the outside firm will still end up with the contract (McAfee & McMillan 1989).

If the contracted firm is located far away, it might be more expensive to monitor its actions and harder to enforce any needed sanctions; this could be especially true if the outside firm is from another country. This might form the basis of an argument for preferring local firms, as using local firms might reduce the costs of monitoring the compliance of contracts and the costs of enforcement in the event of breaches, resulting in a lower total cost even though the price of the service itself might be higher (McAfee & McMillan 1989).

Although there are situations in which deviations from procurement regulations might be theoretically optimal, the overall conclusion in the literature (e.g. Deltas & Evenett 1997) is that such situations are rare and that the benefits of favoring local firms are small even in those cases. Allowing preferential treatment of local firms may give rise to rent-seeking behavior that reduces economic growth, leading to higher taxes and distorted resource allocation (Murphy et al. 1993; Mauro 1995; Bardhan 1997).

We will analyze the empirical case using the theoretical concepts described. Hence, the analysis will be undertaken in terms of the principles of procurement (representing the interests of central government) and the values of local self-government (representing the interests of local government).

## **Empirical example: Bypassing procurement regulations**

Our case is situated in a Swedish county with large rural areas and focuses on the actions taken by public officials in two municipalities with populations of approximately 15,000 and 11,000.

### ***Central and local interests coincide***

The municipalities in the county delegated the procurement of STS to the county's PTA in 2004 (Leksands kommun 2004). In the autumn of 2006, the requirements of the invitation to tender were made public. The tender was divided into two packages:<sup>14</sup> the first concerned procuring cars to be used for publicly funded STS trips only; the second concerned procuring backup vehicles to be at the disposal of STS services when needed and otherwise allowed to be used for private taxi trips. Backup vehicles were procured with the unofficial aim of ensuring the provision of private taxi services in the municipalities (interview with the municipal commissioner of municipality A, 15 June 2010 [Interview A]).

In reacting to the tender, several local taxi companies went to court arguing for the annulment of the process (Widell 2007). Among the requirements in the invitation to tender was that cars registered for use in STS only (package one) were not be used for other purposes (e.g. taking privately financed trips) during the contract period.<sup>15</sup> The companies argued in court that such a requirement would cause them severe financial harm, possibly resulting in the termination of taxi services other than STS (Widell 2006). Both the County Court and the Administrative Court of Appeal rejected demands that the process be annulled (County Court in Dalarnas Län 2006, 2007; Märki 2007).

In what can be seen as an attempt to influence the process, some of the local taxi operators told the press that they would terminate all operations and lay off all employees if they did not win the STS contracts (Jeffer 2006; Widell 2006).

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<sup>14</sup> Though the complete tender included other types of transport services, we are focusing on those concerning taxis.

<sup>15</sup> Such restrictions were probably placed on the cars used in STS because taking private trips between STS trips makes planning STS harder and can cause delays for STS users.

When rating the incoming bids, the bids for package two of the tender – the backup vehicles – were higher than expected, so the PTA responsible for the procurement decided to cancel this part of the procurement (Interview A; interview with the chief executive officer of municipality B, 16 June 2010 [Interview B]; and interview with the chief executive officer of municipality A, 15 June 2010 [Interview C]).

The first part of the tender, covering cars intended for publicly funded trips only, was followed through, and contracts were signed with the winning bidders. The municipalities and county council supported the decision to cancel package two of the tender and sign contracts for only package one, with the restriction that the PTA would secure the existence of private taxi services in the municipalities (Interview A).

Sambus was the most successful bidder, winning most of the contracts up for tender in package 1 (Interview C). Sambus was not located in the county; after winning the contracts, it subcontracted local taxi companies to perform the actual services, allowing local firms to continue operating despite not winning the contracts themselves.

Thus far, the local governments had acted in accordance with the regulations, using competitive tendering to procure public services. It should be noted that steps were taken at this stage to secure the existence of regular taxi services with the support of public funds, though local governments were trying to allocate these resources efficiently through competitive tendering. At this stage, central and local interests were in concert and the actions taken were also in line with the efficiency value as well as the democracy value of local self-government.

### ***An unexpected(?) downside making interests diverge***

Although Sambus subcontracted several local companies, some local firms were not awarded any STS contracts at all. This was the case for the taxi companies that had previously been operating in the two municipalities examined here. Because nearly 90 percent of their revenue had come from supplying STS, they announced that they were ceasing operation, leaving some municipalities in the county without any private taxi service (Cham 2007; Märki 2007).

Local media, local companies, citizens, and tourists raged against the loss of taxi services, and leading politicians in several municipalities (including our two) claimed that measures had to be taken to bring back taxis to the municipalities that now lacked such a service (e.g. letter from the commissioners of the municipalities of Mora, Orsa, Rättvik, and Leksand to Daltrafik, titled “Ang. Försörjning av taxiservice för privatmarknaden i Orsa, Mora, Rättvik och Leksand”, 6 July 2007; email sent to the Municipality of Leksand, subject “Taxi i Leksand”, 12 August 2007).

The leading officials knew that demand for private taxi trips was not high enough to support taxi operations on a commercial basis: an average of only two trips per day was made by a private taxi before it ceased operating indefinitely (Interview A). Despite this, politicians in both municipalities found the lack of taxis a problem and were determined to obtain regular taxi services. On this there was cross-party agreement (Interview B). The public reactions and politicians’ actions seemed to indicate that the existence of taxi services was highly valued despite the low use of the service.

The officials’ main argument for taxi services being of public interest was that tourists, on which both municipalities are heavily dependent, needed taxi services (e.g. Interview B). Another argument was that other local industries were dependent on potential customers being able to travel to various local companies. Yet another was that taxis were needed by people living in the municipalities so they could return home safely after attending a party or an event. Taxis were seen as an important part of the transportation infrastructure by the municipal officials (e.g. Interview C).

This was a change of tactics: initially the municipalities tried to secure regular taxi services through the original tender but, as was pointed out before, this strategy was abandoned as it was deemed too expensive.

### ***Actions taken to bypass procurement regulations***

Having discarded the option of securing taxi services via the regular procurement process, other measures were taken. Intense dialogue began between the PTA, the municipalities,

Sambus, and other companies (Interview C). Sambus and other taxi companies were asked whether they could solve the problem by providing additional taxi service besides STS (interviews A and C). However, the companies were not interested, and the president of Backhans Bus stated, “It is hard to make that financially viable, as it would require that people travel by taxi and we have seen very little of this”<sup>16</sup> (Klockarås 2008). When interviewing leading politicians and the chief executive officers (CEOs) of the municipalities, we found they clearly understood that demand for private taxi trips was insufficient to support a taxi company. One of them stated, “For a while we hoped that it would prove to constitute a commercial basis, which would justify further private taxi business, but it has not been so” (Interview B).

Other attempts were made to address the issue. The larger hotel owners and event managers actively lobbied the municipalities to solve the taxi problem (e.g. email sent by prominent figure in local community, to representative of the municipality of Leksand, subject “Taxiverksamheten”, 8 February 2007). The hotel owners argued that tourist numbers would decline and that they would lose customers. In response to the loss of taxi services, the hotel owners had made deals with taxi companies to provide services for their customers. The public officials in the municipalities knew about these agreements and asked the hotel owners whether they could take on the responsibility for organizing taxi services for non-hotel customers as well. However, the hotels did not want to support the taxi companies or help the municipalities in that way (Interview A).

Hence, one of the main arguments for public support of taxi services (i.e. tourist needs) had in fact been refuted by private sector action<sup>17</sup>. Despite this, leading municipal officials continued their attempt to arrange private taxi services. The hotels and the public kept pressuring them on this issue, trying to transfer the costs to the taxpayers. The municipalities discussed giving a publicly employed janitor the responsibility for driving a taxi as well (Interviews A and C)

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<sup>16</sup> In this context it is worth mentioning that the firms contracted for STS were free to use their cars for regular taxi services outside the time when they were registered for STS use, and that since the deregulation of the taxi market in 1990, anyone with a license to drive a taxi is free to enter the market.

<sup>17</sup> At a later stage, the municipality, when asked about taxi services by tourists, actually referred them to the hotels (e.g. email from to representative of the Municipality of Leksand, subject “Taxi in Leksand,” 6 April 2009).

and also discussed the possibility of starting a public taxi company. Both these ideas were abandoned quite quickly. One of the municipal CEOs felt it would be wrong for the municipality to run taxis. He said, “We do not have the experience – surely, it would be much more expensive than if someone else did it” (Interview B).

It was a stressful time for the leading officials in the municipalities, and it led to a situation in which municipal employees picked up people at the train station and drove them wherever they wanted to go (hence acting like taxi drivers) (Interview A).

A conclusion that can be drawn here is that the leading actors were determined to obtain regular taxi services for their municipalities. Because the existence of regular taxi services was not a requirement from central government, it had to be seen as a purely local initiative. Local government was willing to spend public funds to obtain this service, but did not want to provide taxi services in-house or be saddled with excessively high costs.

### ***An attempt to solve the problem through informal procurement***

After having tried approaches besides procurement, the municipal commissioners decided to try securing the existence of regular taxi services during the tourist season only via procurement (Leksands kommun 2008a). The commissioners argued that, because the municipalities were highly dependent on tourist revenue, they had a strong responsibility to ensure the provision of taxi services to the tourists. One commissioner argued that the tourists arriving in his municipality were used to being able to take a taxi at all hours (Hällberg & Forsell 2008).

The new procurement took place through an informal process that did not require advertising in the European paper TED, so the process was not open to all bidders. Larger invitations to tender for public works and services must be advertised throughout the European Union. This is done through TED, the online edition of the Official Journal of the European Union. An informal procurement violates the principles of nondiscrimination and openness (Nilsson et al. 2005), and such an action would violate the interests of central government. When asked whether or not such a procedure was legal, one commissioner said, “Legal or legal? It is at

least not good, but from our point of view it is the only solution there is” (Bloom 2008a). The CEO of the other municipality felt that it was on the borderline of what a municipality could legally do, but referred to a few court verdicts concerning hotels, which stated that when there was no commercial base, a municipality had the right to offer support with public funds (Interview C).

Before the informal process was complete, however, it was terminated after several local taxi companies took the case to the County Court on the grounds that (i) the value of the tendered contracts was too high to justify an informal process; (ii) such a process discriminated against the companies not invited; and (iii) the municipalities had broken confidentiality in revealing the names of the bidding firms. The court ruled for inhibition, meaning that that the procurement process could not continue pending further investigation (County Court in Dalarnas Län 2008a). The municipalities appealed the decision to the Administrative Court of Appeal (Leksands kommun 2008b). However, due to a tight time frame (the contracts would last only over the summer), they decided to annul the procurement procedure before the court rendered its verdict (Leksands kommun 2008c).

It was a huge disappointment for the municipalities when they realized that the informal procurement could not be completed. The CEO of one municipality stated, “We will lose creditability with both tourists and citizens . . . it ended up looking as though it was the municipality’s responsibility: we had conducted the procurement, which resulted in the termination of taxi services here” (Interview C).

In an effort to save the situation, the CEO of one municipality and the CEO of the PTA tried once again to persuade Sambus to provide regular taxi services (Tällberg 2008; Bloom 2008b). They also negotiated with several other taxi companies (Cham 2008). In August 2008, a press release stated that an agreement had been reached between the municipalities, the PTA, Samres<sup>18</sup>, and a taxi company to run private taxi trips for a “trial period” (Leksands kommun 2008d,e). Other taxi companies went to court and argued that this agreement was in fact a covert procurement. The municipalities argued that it was not a procurement but the

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<sup>18</sup> Samres is the company that is responsible for coordination of STS trips in the county.

renegotiation of an existing contract. In the end, the negotiations failed, and a trial period was not initiated (County Court in Dalarnas Län 2008b, c).

After two years without regular taxi service, and with the summer of 2009 fast approaching, the municipalities once again tried to procure taxi service via an informal direct process inviting selected local firms. This time the informal procurement process ran to completion without being challenged in court. The procurement concerned taxi services from 18 June to 30 August 2009 (Leksands kommun 2009a,b); the contracts were then extended to last the year, to December 2009 (Leksands kommun 2009c).

### ***Taxi on commercial grounds or subsidization of private firms?***

Since 2 January 2010, the company Stor och Liten has been providing regular taxi services in the studied municipalities, without any procurement having taken place. However, it should be mentioned that the municipalities are paying the company money for commercial space on some of their cars. The municipal executives have somewhat different accounts of this. One of them regarded this action as sponsorship, stating, “We buy some advertising space from them for the same price as they rent their facilities, so in practice, the facilities are free” (Interview B). Another holds another view of the arrangement, claiming that the company’s decision to operate in a market previously deemed unprofitable and the municipality’s decision to buy commercial space were unrelated (Interview C; Hällberg 2010). This arrangement, which is ongoing, is likely to be seen as direct support of a private firm by any court and is not in accordance with procurement principles.

## **Discussion: Rationality in local decision making of public procurement**

How then can we understand the actions of the local decision makers in relation to the procurement of local services? First, one should acknowledge that there appears to be support for the most fundamental aspect of the central government interest; that is, opening up to competition does result in lower costs. The provision of STS could then be seen as a task where local and central interests coincide. The first option tried by the local authorities was

therefore to comply with the central government (and procurement regulations) and undergo a process of competitive tendering. It was only when this process gave rise to an unwanted outcome that the local actions started to deviate from the central government's demands.

It should also be mentioned that in neither of the municipalities did public officials want to provide regular taxi services in-house. This could be taken as support of the assumption that the private sector is better at providing such services. In the case observed here, it is not the outcome of the service that was specifically procured (STS) that was deemed unsatisfactory – the loss of regular taxi services was seen as the problem<sup>19</sup>. Because there is agreement on the efficiency of procurement through competitive tendering as a means to lower costs (efficiency value of local selfgovernment), one has to look at the democracy value to understand why the procurement results are perceived as unsatisfactory from a local point of view. Although on average no more than two trips per day are taken by a private taxi in the examined municipalities, the existence of a taxi service is nevertheless considered valuable. To understand the strong support for local taxi services, we turn to the concepts of option values and existence values (Krutilla 1967; Kriström 1990).

The show of citizen support via the media and direct communication with the local government indicates that there is some value put on the possibility of using taxi services. The value of having the opportunity to make a specific choice, but not necessarily ever using that opportunity, is usually called option value (Kriström 1990). In addition to the direct value to users and the option value to potential users, there is also evidence of what can be seen as existence value; that is, people valuing something even though they do not use it and probably never will (Krutilla 1967; Kriström 1990). In the case of taxi services, this can be seen in the embarrassment of decision makers and the public at the loss of taxi services. The general opinion was that a “proper” municipality has access to proper taxi services. The officials interviewed stressed that private taxi services should be seen as integral to a functioning local infrastructure and therefore as a public-sector responsibility. Apart from this, local businesses

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<sup>19</sup> Efficiency in the provision of STS therefore refers to obtaining STS service, with a specific level of quality, at the lowest cost possible. At the same time efficiency in the provision of regular taxis refers to obtaining regular taxis at the lowest cost possible (at a specific quality level). The municipalities chose not to sign the second part of the contract (regular taxis) because they found the bids to be too high. It is therefore possible to acquire STS in an efficient matter even though regular taxis were excluded from the deal.

exerted considerable pressure on the municipalities to secure the existence of taxi services. The option value, existence value, and direct value to actual users can be seen as the foundation of the local opinion of regular taxi services and thereby makes these values a part of the democracy value of local self-government<sup>20</sup>. The decision to provide taxi services might therefore be warranted; however, it is important to separate the discussion of what kind of services the municipality should provide from the discussion of how they should be provided.

The local authorities' response to the procurement outcome was driven by pressure from local businesses and the public as well as by a belief that a well-functioning municipality should have access to taxi services. Such influences can be seen as part of a local context that must be taken into account to understand the actions taken. From a policy implementation point of view, it is when what is perceived as in the local interest – that is, the driving force behind the local government's interest – differs from that of the central government's interest that the implementation of the latter becomes problematic if not impossible. In our example, compliance with procurement regulations is thought to increase efficiency in STS (i.e. by providing existing service at a lower cost or a better service at the same cost) through competition. At the local level, this results in the loss of private taxi services, which runs counter to perceived local interests. The results are that substantial resources are focused on bypassing procurement regulations.

In striving to change what was perceived as an unfavorable outcome, the municipal officials expressed considerable frustration at the procurement laws, claiming that they were not suitable for application in rural areas. Therefore, considerable effort was put into attempting to expand the boundaries of these laws; even though the officials tried to stay within the confines of the law, many actions taken approached those boundaries and some transgressions did occur. As illustrated in the material, the sentiment could be expressed as follows: It is important to be in compliance with the laws, but even more important to achieve the desired outcome at the local level.

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<sup>20</sup> To determine whether it is efficient to provide the service, these values should be compared with the costs of providing the service.

It can be concluded that even though the central government's demands are present in the procurement process, the local government's interests are allowed to dominate. The importance of the local context, prioritizing what are perceived as local interests and fondness for a specific geographic area, has been stressed in many academic disciplines. These disciplines focus on the relationships between people located in a specific area trying to achieve something in that area (e.g. Waldenström & Westholm 2009); our results can be seen as part of this tradition.

The actions taken by local officials can be understood in terms of values that are found in the local self-governmental act, in this case expressed in efforts to satisfy local interest groups and public opinion. What are the practical outcomes of the various actions taken by the officials? The first outcome is that there is in fact deviation from the nondiscrimination principle, local taxi firms being given preferential treatment in the procurement process as well as direct subsidies through what are called payments for advertising. It should be stressed that giving preferential treatment to local firms in procurement processes is equivalent to subsidizing them, this being financed by local taxpayers through the local government budget. Because subsidizing individual firms is illegal in Sweden, it is perhaps fortunate for some municipalities that subsidization through preferential treatment in procurement processes is less transparent than direct, overt subsidization<sup>21</sup>.

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<sup>21</sup> According to Article 106 of the TFEU, undertakings of general economic interest should also be subject to the rules in the treaties, in particular to the rules on competition, unless the application of the rules obstructs the performance of the task. Because the municipalities could have procured regular taxi services in competition (as they originally intended) following the procurement and competition, regulations would not have obstructed the task even if regular taxis were to be seen as an undertaking of general economic interest. Article 107 of the Treaty of the Functioning of the European Union (TFEU) states that public support of certain undertakings or production of certain goods that distorts competition is in violation of the functioning of the internal market and it is therefore not allowed. The article also provides exceptions from this rule of which only one might be considered relevant in this case. Such support is allowed if it is given to facilitate the development of certain economic activities, which in our case would be taxi services in rural areas. Our interpretation of this is that the municipalities are allowed to support the development of taxi services but this does not mean that they are allowed to give support to specific local firms without giving other firms the opportunity to obtain the same support. Hence they should have used procurement through competition to determine which firms to support. Regulation 1370/2007 on public passenger transport services by rail and road states that the relevant authority is allowed to intervene to secure transport services of general economic interest. If a private taxi service (performing two trips a day) is defined as being of general economic interest, the authority is allowed to provide the service themselves or procure the service from a third party. If a third party is used, as in this case, procurement through competition is to be used. Exceptions are allowed if the values of the contracts are below the threshold values, unless it is forbidden in national law. Therefore this

The second outcome of the officials' actions is that the actions serve as indirect support for the local business community, because it gains access to a taxi service without having to pay its full cost. If the business community truly valued the service at its actual cost, it would provide the service itself. The costs of these actions are borne by taxpayers through higher taxes or lower service levels in other areas of public service or both.

Finally, a third outcome is the risk of diffusion effects, which can be seen when comparing this case with other cases of bypassing procurement regulation. The fear of losing regular taxi services due to STS procurement was used by local decision makers (in places that still had access to regular taxi services) to justify giving preferential treatment to local firms in procurement processes. An example of bypassing was found when a procurement was divided into small packages in order to give preferential treatment to local firms and reduce the likelihood of larger national or international firms finding it worthwhile to compete (interview with the municipal commissioner of municipality C, 9 December 2008 [Interview D] and with the civil servant responsible for public transport issues in municipality C, 9 December 2008 [Interview E]). Another example was the use of informal procurements in which only local taxi firms were invited to participate (interview with the civil servant responsible for public transport issues in municipality D, 10 December 2008 [Interview F]). Such ex ante bypassing of the procurement regulations occurred before, or in the early stages of, the procurement process. The fear of loss of regular taxi services and the actions taken in reaction to this are empirically argued to be the origin of further deviations from procurement regulations in other municipalities.

## **Conclusions**

There can be little doubt that there is a value to having access to taxi services and thereby having the option of using them when making travel decisions. It is also apparent that local businesses, in both tourist-related and other sectors, find the existence of private taxi services

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issue is to be settled by Swedish courts (which also take EU laws and regulations into account) to whose decisions we have previously referred.

valuable; this is evident in their attempts to influence public officials to take action to secure the provision of private taxi services through public funding.

Given that private taxi services are valuable in rural areas, two questions could be asked from an efficiency point of view: (i) Do the benefits, including option and existence values, of private taxi services outweigh the costs of providing them? (ii) If so, could these services be provided in compliance with the law, that is, via procurement through competitive tendering? Although these questions are not completely answered here, some points deserve to be made. User values could be covered by customer payments for using taxi services; however, in the rural areas examined here, these are obviously insufficient to support the existence of the services on their own<sup>22</sup>. That leaves the option and existence values to cover the rest of the costs. Whether or not that is the case is an empirical question that remains unanswered.

An important issue that merits further investigation is whether the procurement laws in fact cause problems that are specific to rural areas. One potential problem originates from the structure and organization of local businesses, which can be illustrated by the current case. With such low density of demand, obviously no firm can survive with private taxi service as its sole revenue source. The necessity of combining taxi operations with other services is therefore clear. This illustrates Adam Smith's statement that "division of labor is limited by the extent of the market" (Smith 1776, pp. 35) which is to say that if demand in a specific market area is too low, it is impossible to achieve the full benefits of specialization in the same way as is possible in urban areas, and firms and individuals must engage in several business areas that could be more or less related. For example, it is not at all uncommon for a farmer to be active also in the tourist sector or to be a part-time taxi driver. Having multiple sources of revenue enables firms to be active in businesses in which local demand is low. In our case, having a contract for STS provision makes it possible to provide private taxi services as well. The important implication of this is that the loss of one income source might force a firm to shut down its services in other areas, if the business as a whole is no longer profitable.

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<sup>22</sup> If private taxi services can be combined with other revenue-generating activities, they only have to cover their variable costs in order to be provided.

Taking this into account, overly rigid procurement laws might result in the shutdown of businesses in unexpected areas if some firms lose contracts in other areas. The possibility of such occurrences raises the question of whether current procurement laws might be harmful to economic activity and overall efficiency in rural areas. The answer to that question, however, exceeds the scope of this article and must be saved for another time.

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