



Gustavo Piga

gustavo.piga@uniroma2.it; @gustavopiga

Università di Roma Tor Vergata

Director, International Master in Public Procurement Management

Revitalising infrastructure in times of serious international tensions and rising commodity prices

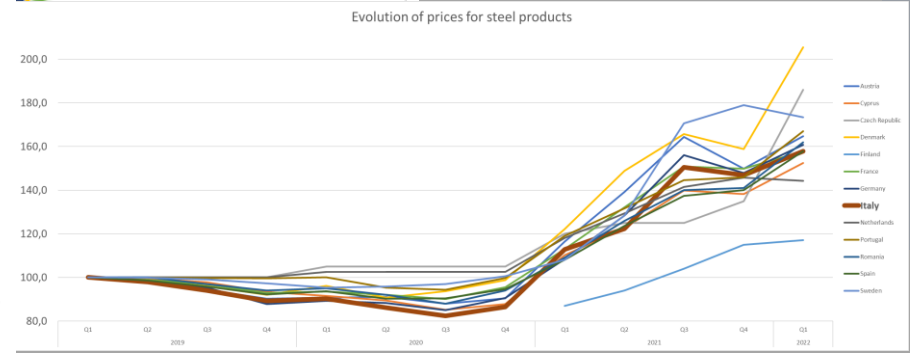
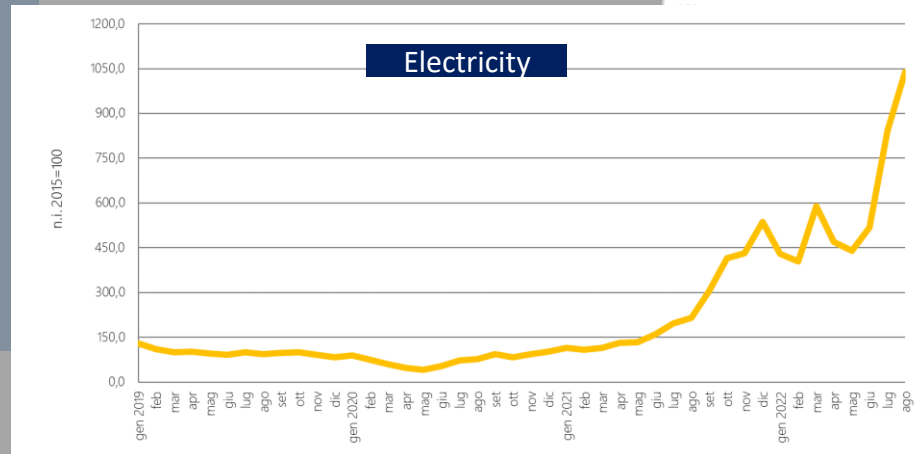
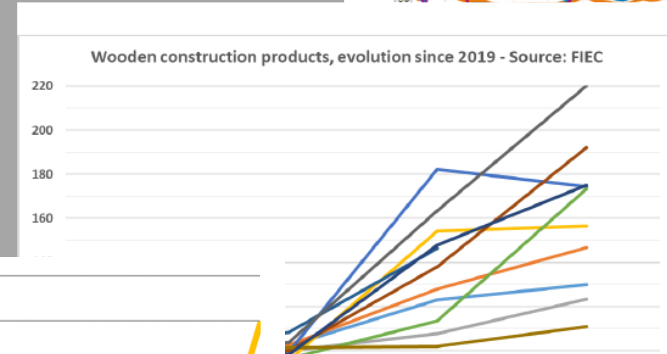
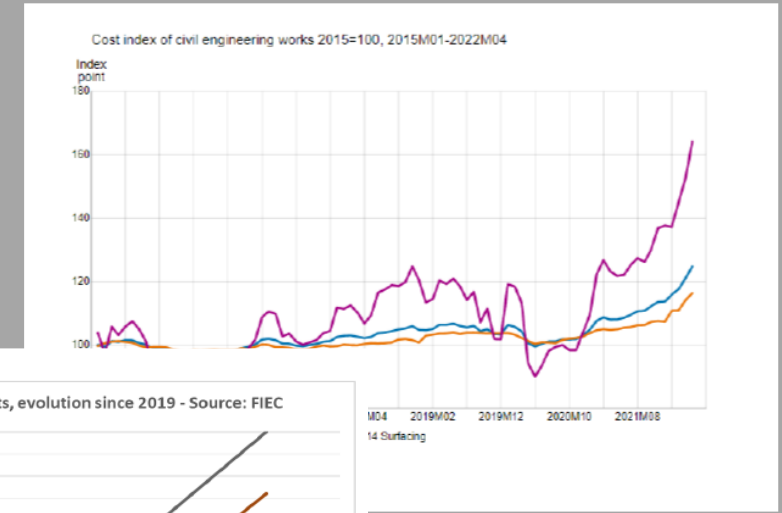
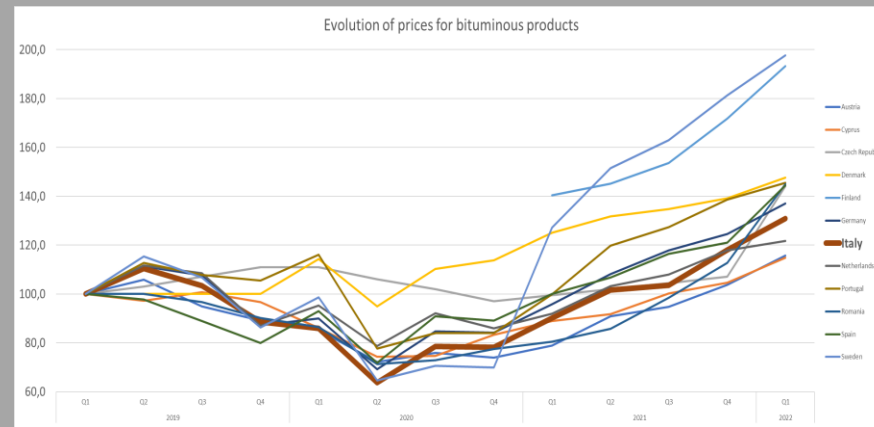
Contractual Arrangements to Meet the Supply Chain Challenges

Opportunities for European international contractors - Will we see a real recovery?

Rome, 30th of September 2022

The scenario is clear...

... and very worrying



Not only rising costs.

Shortages and inflation

" 'At some point you really do run into restraints. . . . And the way you know that is that deliveries on materials begin to slow down, shortages begin to pop up, and you have all sorts of collateral indications that the system is running into shortages.'

*. . . . The worry of **Mr. Greenspan** and other economists is that such tightness, if it persists, will eventually bring on inflation pressures"*

(Wall Street Journal, April 6, 1995, 2).

Modigliani and Fisher

“Towards an Understanding of the Real Effects and Costs of Inflation”

1978

However, in economies that have not fully adapted to inflation -- and that means all economies -- potential real effects are far more pervasive. Some of these real effects are very hard to pin down -- for instance, the extent of misallocations caused by variability of relative prices and uncertainty of future price levels, but they may well be as important as the costs that are conventionally emphasized.

Governments frequently attempt to suppress inflation using wage and price controls. Such controls are likely to produce serious distortions and inequities, particularly when they are introduced at times of excess demand. Measures of the extent of the distortions for particular cases have apparently not been undertaken, though anecdotal evidence on shortages induced by wage and price controls abound.

IV. Real Effects of Unanticipated Inflation Through Existing Nominal Contracts

Existing contracts for goods or services fixed in money terms or otherwise sticky

17. Redistribution between buyer and seller if quantity of services fixed by contract

18. Effects on quantity of services provided.

G17-19 Effects on level of economic activity (Phillips curve)

Short-run functional income redistributions by income size

G19. Misallocations of resources

Effects and Costs for the Infrastructure Industry

V. Real Effects of Uncertainty of Future Inflation

Need to make decisions
without knowledge of
future prices

22. Reluctance to make future
commitments without knowledge
of prices; absence of safe
asset

G22 Changes in patterns of
asset accumulation

23. Shortening of nominal
contracts

G23 Increased transaction
costs of making frequent
contracts, and loss of
planning ability

A second effect of uncertainty about the rate of inflation is the shortening of contracts. Uncertainty about the real value of the quid for which the quo is being exchanged is likely to reduce the use of long-term contracts. Uncertainty about the rate of inflation should lead also toward the use of indexed contracts.

How to Deal?

Micro level

Supplier

Understanding which categories face inflation and their current contract terms helps in crafting responses.

Process excellence center's response matrix

Degree of exposure	Contract type	
	Existing	Inflation
High (all future) related contracts	Play offense <ul style="list-style-type: none">Improve bids to meet business-unit's needsStreamline contracts to protect bottom marginRe-evaluate frequency of re-forecasting	Defend <ul style="list-style-type: none">Integrate category from spend to measure and drive riskStreamline costs, managing negotiated itemsAggressively pursue contract renewals
Low (all related contracts)	Explore alternatives <ul style="list-style-type: none">Seek alternative relationships (spot/bid)Find price indexStreamline operations, managing negotiated items	Attack <ul style="list-style-type: none">Cancel terms of contractsTake out environmental costs, e.g., making capital assetsEstablish long-term (2-3 yr) contracts (e.g., supplier, multiple)

McKinsey
& Company

<https://www.mckinsey.com/capabilities/operations/our-insights/responding-to-inflation-and-volatility-time-for-procurement-to-lead>

How to Deal?

Micro level - USA

(Public) Buyer and Supplier



9/12/2022

GSA Office of Government-wide Policy

Acquisition Alert AA-2022-02

MEMORANDUM FOR THE GSA ACQUISITION WORKFORCE

DocuSigned by:
Jeffrey A. Koses
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FROM: JEFFREY A. KOSES
SENIOR PROCUREMENT EXECUTIVE
OFFICE OF ACQUISITION POLICY (MV)

SUBJECT: Guidance on Addressing Inflation in GSA Contracts

2. Why is there a need to emphasize this now?

Inflation and uncertain economic market conditions erode scarce contracting dollars, cause severe hardship on federal partners, and discourage new entrants from pursuing federal acquisition.

The acquisition workforce has both the authority and the tools to take action to mitigate the impact of inflation in federal contracts. Overall objectives should be around working with GSA contractors to reduce risk rather than shift risk from one party to the other.



GSA temporarily lifted restrictions on economic price adjustments (EPA) in its contracts in March to fight inflation. With prices still rising, the agency this month extended the flexibilities through March 2023 and said officers can now make adjustment decisions without the need for approval from a more senior official.

How to Deal?

Micro level

Expert and
Trusted (Public)
Buyer...

and Supplier

Infrastructure??

(iii) Contract Administration and EPAs

Many EPA clauses include indices. During contract administration, if the acquisition team learns that an index is not effectively tracking market fluctuations, the contracting officer may change the applicable index through a bilateral modification.

In times of high inflation, the longer a contract award takes, the less purchasing power GSA has. For example, if inflation is running 10% a year, and GSA was given \$1,000,000 for a project, if the contracting activity awards in 3 months, GSA would have the equivalent of \$975,000 in purchasing power. Whereas if it took the contracting activity 9 months to award, the purchasing power would shrink to \$925,000.

In times of economic uncertainty, contracts extending over a relatively long period (e.g., greater than 5 years (or 60 months) may not be the best decision for either the contractor or GSA. The economic uncertainty and unpredictability may result in very high prices in order to accommodate for significant spikes in market pricing, or may result in less competition due to contractors not being willing to take on risk over such a long contract period³.

Therefore, acquisition planners are encouraged to consider reducing the total period of performance for acquisitions in order to help contractors more reasonably predict costs and not take on so much risk.

Europe's
response

1

Competence/
Autonomy US
style?

How to deliver selected operations against price hikes and distortions in supply chains and labour force?

- Two basic options for problematic operations with **ongoing procurement**:
 - modify the existing contract in terms of either time, scope, and/or prices
 - contractor decides to terminate the contract and the CA needs to re-tender
- In case the contracting authorities decide to continue with specific operations, **who can cover additional costs**:
 - Beneficiary
 - Other national funds
 - **EU support can be increased** if programme still has resources, otherwise phasing should be considered and resources from 2021-27 added to the project

Semantics

- *Inflation? Scarcity? Where do they come from?*
 - *Ask a sociologist not an economist...*
 - *"Imbalance of" and "struggle for" power!*
- *In the 1970s: trade unions vs. firms; OPEC vs. RoW*
 - *Today?*

The current imbalance

- “Supply of raw materials has become a real **geopolitical** tool”.

- Commissioner Thierry Breton

- https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_5523
 - Critical Raw Materials Act: securing the new gas & oil
 - at the heart of our economy

The XXI century's challenge is huge.

Geopolitical imbalances are stretching a fragile Europe to the limit.

Europe's
response?

Infrastructure is at the heart of re-balancing power

What about our European Industry's capacity?

2

Especially after austerity and the Fiscal Compact?

A long-term European **rebooting and rebuilding** of a public and private infrastructure policy - well beyond and above the Next Generation EU - is needed.



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THANK YOU

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