

GOVERNMENT PROCUREMENT

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Theoretical and empirical knowledge on issues related to government procurement in preferential trade agreements (PTAs) is sparse. It consists mainly of taxonomies of legal provisions on government procurement and economic models of across-the-board (i.e., nondiscriminatory or nonpreferential) reductions in discrimination against foreign bidders for state contracts. To the best of our knowledge, no ex post empirical assessments have been conducted on the impact of PTA provisions dealing with government procurement on trade flows or on the effectiveness of national procurement institutions, nor are there evaluations of the extent to which these PTA provisions have been implemented or of whether national procurement authorities have changed their practices as a result of PTA provisions. The analysis of government procurement in PTAs is a nascent discipline, and readers are cautioned accordingly.

The purpose of this chapter is to describe what is known concerning public procurement provisions in PTAs and what factors ought to be taken into account by policy makers and analysts as they evaluate policy options in this area. Although an effort is made to draw appropriate policy implications, the findings are largely tentative and will need to be revised in the light of new evidence and changes in thinking as to what constitutes effective public procurement policy.

The section that follows examines the developmental aspects of government procurement and associated reforms in the context of trade agreements. The second section surveys the major types of PTA provisions on government procurement found in selected agreements, with particular attention to dispute settlement provisions. The third section then assesses the government procurement provisions found in PTAs in a multilateral context, focusing on the important matter of discrimination. Some lessons for policy making are set forth in the concluding section.

Economic and Developmental Dimensions of Government Procurement

At the outset, it is critical to understand the development context in which discussions of government procurement policy in trade agreements take place. Proposals for public procurement provisions should be informed by circumstances in developing countries. As with many “trade and . . .” matters, it would be unwise to design or assess proposals for trade disciplines related to public procurement without a clear understanding of existing state purchasing practices and their potential developmental significance. In particular, it is important to examine the potential scope of government procurement, the relevant factors affecting national procurement regimes, the objectives of these regimes, and the underlying principles of good procurement policy before drawing inferences about trade negotiations and obligations bearing on public procurement.

Procurement Spending as a Share of Total Government Spending

A distinction must be made between all government spending and what is typically referred to as state spending on goods and services. (Spending on wages, salaries, and pensions is part of the former, but not the latter.) The significance of this difference for development is that wage rates are much lower in developing countries than elsewhere, and so the cost-effective way of supplying a given level of public service is to use more labor-intensive methods. Consequently, the share of spending on capital and intermediate goods will, other things being equal, be lower in developing countries, and this—setting aside the level of national income—accounts for the relatively small size of these countries’ public procurement expenditures.¹

However small public procurement expenditures are in relation to the size of the economy, the manner in which such monies are spent has an important developmental effect. Many public goods and services have a direct or indirect effect on economic performance and living standards—in particular, the living standards of the poor, who tend not to be able to afford private alternatives. Effective national procurement policies can help improve the execution of state infrastructure projects, yielding export and growth benefits. A government that is pursuing recognized development goals should, consequently, strive to limit waste and corruption in its public procurement regime.

Factors Affecting National Procurement Regimes in Developing Countries

Procurement regimes do not necessarily affect all levels of government in the same way. Total state spending on goods and services is distributed across various levels of government within a nation. Constitutional arrangements—in particular, federalist structures—affect which levels of government do the spending, how much they spend, and for what purposes. It is unwarranted to assume that just because one level—say, the central government—engages in public procurement reform (perhaps unilaterally, perhaps in the context of a trade agreement), other levels will follow suit. Constitutional niceties matter when evaluating the likely significance and impact of public procurement reform.

Government procurement in developing countries could also conflict with other—at times, externally imposed—constraints on the composition and implementation of public spending. Externally funded budget support programs, tied aid from donors, and debt relief initiatives all affect the level of government spending on goods and services and the extent to which the associated contracts are open to national and international competition. A distinct implication of these schemes is that their existence may limit the scope of national or regional public procurement reform initiatives, unless particular care is taken to reconcile the latter initiatives with bilateral or other international obligations.

In addition, many developing-country governments experience institutional and administrative capacity constraints, including a paucity of trained procurement staff. As the discussion below illustrates, there are many methods of public procurement, and the state officials responsible need to be well versed in their design and execution. Performance evaluation of contractees is required, and contract management, reporting, and accountability are important tasks, especially in an era in which a premium

is placed on transparency and good governance. A number of jurisdictions recognize that the management of procurement systems is a distinct, highly valued profession, and that, as in many cases involving talented personnel, staff retention and motivation are important challenges.²

Objectives of National Procurement Regimes

A common feature of public procurement policies that almost always colors debates about reform in both developing and industrial countries is the multiplicity of objectives assigned to these policies. A review of national public procurement legislation and implementing regulations shows that the following objectives are commonly targets of public procurement policy:

- Value for money, typically taken to mean minimizing procurement costs
- Macroeconomic management
- National security
- Redistribution to the poor
- Industrial and regional development
- Promotion of small and medium-size enterprises (SMEs)
- Support for state-owned enterprises and their employees
- Pursuit of governance-related targets.

In practice, pursuit of any but the first target amounts to designing procurement systems that sacrifice the value-for-money goal, in whole or in part, for some other objective. Advocates for giving preference to a particular regime typically appeal to some apparently inviolable principle such as transparency or defense of small business, but the risk of wasting scarce state resources is high if governments are swayed by abstract principles.

The alternative for governments is to use other state instruments, when available, to attain a particular target.³ It is, to be sure, possible to use a national procurement regime to support local industrial development, and a government policy of imposing high costs on foreign enterprises attempting to establish and do business in the country will indeed stimulate incumbent firms. But if those existing firms are particularly confident, they may simply raise the prices charged the state buyer. In such a case, not only is the policy misguided, but it might exacerbate the exercise of market power and the distortion of resources within the economy. Much is at stake in the design of public procurement policy—not just the capacity to do some good, but also the danger of doing further harm!

When pursuing an objective other than value for money, policy makers and analysts need to ask under what circumstances government demand would directly and least expensively meet the targeted objective. To this line of argument, some will respond that the “real” world is imperfect and often requires second- or third-best solutions. Experience indicates that this objection would be stronger if it were made after alternative government policy instruments had been evaluated and rejected as potential means to a stated end.

Four Broad Principles of Good Procurement Policy

Despite, or because of, the variety of government objectives for public procurement policy, most jurisdictions, international accords, and pronouncements of international organizations on public procurement tend to refer to a core set of “principles” for the implementation of national policy in this area. Governments desire to retain the freedom to use procurement policy to pursue policy objectives that may be different from their neighbors’ objectives. In this context, the core principles may be seen either as a limited approach to liberalization or as an agreement on higher-level disciplines that guarantee good policy making and governance. For governments negotiating a common approach to procurement reform—perhaps through a PTA—these similarities in principles may make it easier to reach consensus despite differences in overall objectives for public procurement policies.

Over time, the following four principles appear to have gained considerable common support: (a) efficiency (value for money); (b) equality of opportunity to compete for state contracts (nondiscrimination); (c) transparency (control of corruption; accountability); and (d) encouragement of investments and partnerships (public-private partnerships).⁴ The principles may be codified in national constitutions, national and subnational laws, implementing regulations, and binding and nonbinding international accords. Associated with the principles are particular steps that the government can take to attain them.

Efficiency. It is widely accepted that the value-for-money objective is best achieved by encouraging (through the design of an easy-to-understand, easy-to-participate-in, and fair procurement regime) the maximum number of bidders for a state contract. Simulation evidence strongly suggests that the expected cost to the government of a contract falls as the number of bidders increases, and especially as the number rises toward five or six (McAfee and McMillan 1989; Deltas and Evenett 1997).

For many developing countries, the inefficiency and opportunity cost of suboptimal levels of competition in

national procurement regimes can be substantial. For an average developing country that spends about 15 percent of its national income on goods and services, a 10 percent saving on procurement contracts is equivalent to 1.5 percent of gross domestic product (GDP)—an amount that may exceed the total amount of aid received by many developing countries.

Equality of opportunity. Entrenching equality of opportunity to compete for state contracts involves eschewing provisions that limit, bar, or discourage firms from bidding, on the basis of location, sourcing decisions, and employment practices.⁵ Bans on foreign bidders, as seen in certain “buy-national” legislation passed during the 2008–09 global economic downturn, involve violations of equality of opportunity (see box 17.1). The matter here is not simply a case of domestic versus foreign firms but also of discrimination between foreign firms, as discussed in the next section.

The adverse welfare effect from discriminating against foreign bidders is, however, not straightforward to establish theoretically. Baldwin (1970) and Baldwin and Richardson (1972) show that when the quantity of a good that the government seeks to buy is smaller than the total quantity supplied by domestic firms, prohibiting foreign firms from bidding on state contracts merely reshuffles

Box 17.1. Persistence of Discrimination: Procurement Practices and the Global Economic Crisis

The 2008–09 global economic downturn has created doubts about the effectiveness of the rules and disciplines governing government procurement contained in trade agreements. The widespread use of fiscal stimulus packages has added a further layer of factors and potential complexity. Some governments have included “buy-national” provisions in fiscal stimulus packages to coerce state agencies into buying “domestic products.” Defining what exactly a domestic product is often proves elusive, and so the laws underpinned by such notions can be confusing.

This being said, buy-national provisions have the potential to affect the international outsourcing decisions of firms and the operation of their supply chains. A developing country may find that both its intermediate and final goods producers lose sales abroad when a trading partner implements restrictive buy-national policies. These policies introduce a form of cross-border discrimination against foreign commercial interests in an area of corporate strategy making (international supply chains) that has benefited significantly from open borders over the past two decades. Moreover, for developing countries in which participation in international supply chains is viewed as a way of encouraging the upgrading of exporters, the consequences of being barred from certain commercial opportunities through buy-national provisions may not be confined to lost sales.

purchases from foreign producers from state buyers to local private sector buyers, without any impact on local prices and local production levels. In other words, the existence of discrimination and its subsequent removal may have no effect on resource allocation.

The same analyses showed that only when the total amount demanded by a government exceeds the total quantity supplied by domestic firms does banning foreign bidders increase domestic output and prices and limit imports. If the good in question is one that is supplied in small quantities in a developing country—perhaps because the legal and governance environment is less than ideal for business—such a ban on foreign procurement can indeed lead to expansion of domestic output.⁶ For this reason, nationalistic procurement policies are regarded in some quarters as part of the industrial policy toolkit.

In brief, the economics of discrimination in public procurement is different from that of tariffs, precisely because the former applies only to a subset of buyers.

More recent analyses focus on cases in which discrimination did limit market access (see, e.g., Evenett and Hoekman 2005). The increase in prices paid by state buyers following a ban on foreign procurement tends to encourage the entry of domestic firms willing to supply the government, and so the longer-term effects of procurement discrimination depend on the magnitude of local barriers to entry. With no such barriers (whether administrative or in the shape of anticompetitive practices by incumbent firms), the procurement discrimination could, in the long term, lead to an expansion of domestic output. In a competitive market, moreover, prices would fall in the longer term to the lowest level of average costs of the most efficient local firm, which may or may not be equal to those of the most efficient foreign rival. If it turns out that in the longer run the most efficient local firm has costs equal to or less than those of its most competitive foreign rival, the government will end up paying prices at or below world prices; implying that under these circumstances there is no adverse price impact from discrimination in the long run. The policy implication of this argument is as follows: the longer-term impact of procurement discrimination on resource allocation and state budgets is contingent on national competition law and its enforcement and on policies toward the entry of new business.

In some cases, such as the provision of health care and other professional services, the principle of equality of opportunity is tempered by the realization that it should only apply to qualified or sufficiently expert or experienced bidders. Without challenging the contention that expertise is needed to fulfill certain government contracts, the question arises as to whether the qualifications to bid can be

made as nondiscriminatory as possible. For instance, if a particular skill is absolutely needed, the qualification requirement should be based on that skill—on nothing else, and certainly not on how that skill was acquired. In many instances, however, governments are adamant in asserting that only the graduates of specified national institutions have the skill in question.

Transparency. The importance of transparency in government procurement is generally well accepted. It is often argued (Anderson et al. 2009) that transparency helps improve governance and limit corruption and discrimination; the latter consideration points to a potential complementarity across principles. However, not every aspect of the procurement process can be made mechanical and transparent (the evaluation of intangible attributes of bidders is an example), and the pursuit of more transparent procurement policies will not completely eliminate opportunities to engage in discrimination. Furthermore, achieving transparency is costly. Although transparency can encourage more firms to bid for state contracts, thereby intensifying competition and lowering procurement costs, it also entails costs, such as delays in awarding procedures. The optimal degree of transparency is therefore unlikely to be infinite, and reasonable people can disagree over that degree. Still, the general principle that the procurement process should be known, understandable, and inexpensive to monitor remains key.

The relationship between transparency and market access can be ambiguous (Evenett and Hoekman 2005). Making procurement regulations easier to understand and more accessible will encourage foreign bidders for state contracts but will also attract domestic ones. Whether the share of state contracts awarded to foreign firms goes up or down will depend on the relative responsiveness of both types of firm to improvements in transparency. It is quite possible that a foreign trading partner could argue for the inclusion of transparency-related provisions in a PTA and subsequently discover that the implementation of those provisions actually benefits the domestic contractors of the partner country.

Improved transparency is one of the few areas in which there is some empirical evidence of the impact of procurement reform.⁷ Information on contracts entered into by member states of the European Union (EU) between 1995 and 2002 and on the number and “nationality” of firms bidding for those contracts shows that during the period, the average number of bidders increased by 30 percent, the number of foreign subsidiary bidders rose to 30 percent of the total, and the dispersion of prices paid for comparable products by state buyers fell by 30 percent. Interestingly, it was found that during the same period, 78 percent of all

state contracts examined went to small and medium-size enterprises, suggesting that transparency reform has not eliminated the capacity of SMEs to compete for these contracts.

Encouraging investment and public-private partnerships. Since the early 2000s, the principle of encouraging public-private partnerships in government procurement has gained momentum. In recognition of both tight budget constraints and the growth of private sector capital markets, governments have sought to fund investment (or capital) projects with contributions from the private sector. Although the contractual circumstances are hardly uniform, a private sector partner typically puts up the capital for a state project in return for the right to operate the related state facilities and charge users of those facilities. Many such partnerships are effectively off the government's balance sheet, precisely because the private sector advanced all the financing, but the associated transactions are still part of government procurement and ought to be treated as such.

Implications for Negotiation of Trade Obligations Concerning Public Procurement

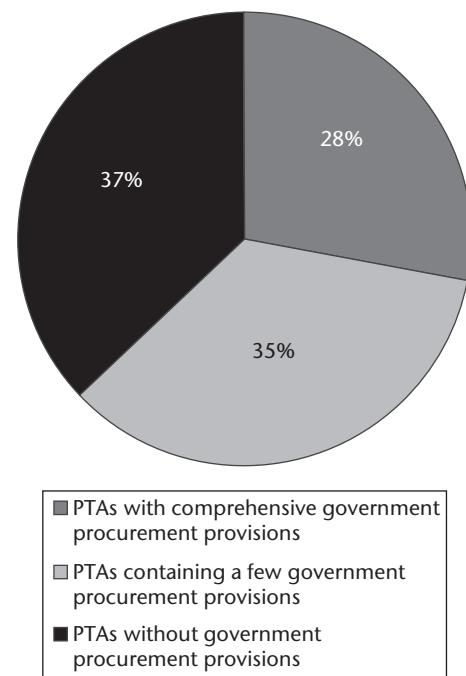
The motives for negotiating and agreeing on public procurement provisions in PTAs are not limited to market access. Provisions of trade agreements fall broadly into three categories, delineated by their specific objectives: entrenching rules, limiting cross-border discrimination (thereby opening markets), and promoting state-state cooperation and the orderly settlement of disputes. Government procurement, like other behind-the-border issues, falls into a fourth category, as the provisions on this subject also deal with the establishment, funding, operations, and review of the public institutions associated with the national procurement regime. A government might strategically accept binding rules on its national procurement regime because, in the government's assessment, these rules are the most effective way of reforming national practices. Consequently, it is misleading to think in terms of the gains of these provisions solely in terms of what additional sales can be made in a trading partner. Market access is not the only possible benefit, and PTAs can contribute toward institutional improvements that have significant development payoffs.

The possibility that trade obligations can be used to improve a national procurement regime immediately raises the question of whether there are other, potentially more effective, vehicles available to governments for attaining the stated ends. In principle, changes in national legislation or in a nation's constitution are alternatives, and the

question arises as to why provisions in a trade agreement present a more credible, more effective, or more feasible option. Much depends on the legislative and constitutional history of the developing country in question—reneging on national legislative and constitutional commitments may involve less risk for some governments than breaking their pledges to a powerful trading partner. The key point is that alternative reform vehicles exist for public procurement regimes, and the case needs to be made that, given its history and other relevant circumstances, a developing country's interests are best served by signing public procurement provisions. Put this way, it may be the case that no generalizations about the desirability of public procurement provisions in trade agreements are possible. And just because not every developing nation will benefit from such provisions does not imply that no developing country will.

As is shown in figure 17.1, two-thirds of the PTAs notified to the World Trade Organization (WTO) since 2000 include provisions related to government procurement, and about 28 percent of extant PTAs treat government procurement in a comprehensive way. (See the annex to this chapter for a list of PTAs with government procurement provisions.) But PTAs are not the only instruments that regulate government procurement on an international scale (see box 17.2) Nonbinding guidelines, such as the

Figure 17.1. PTAs Containing Government Procurement Provisions, 2009



Source: Anderson et al. 2009.

Box 17.2. Three International Government Procurement Instruments

The three basic types of international instruments on government procurement, and the principal examples or actors, are as follows:

Model procurement codes, guidelines, and statements of principles or best practices

- United Nations Commission on International Trade Law (UNCITRAL) Model Law on Procurement of Goods, Construction and Services
- United Nations Convention against Corruption
- Asia-Pacific Economic Cooperation (APEC) Nonbinding Principles

Procurement guidelines imposed by central financial institutions

- World Bank
- Regional development banks

Binding agreements or directives

- World Trade Organization (WTO) Government Procurement Agreement (plurilateral)
- Preferential trade agreements (PTAs): European Union (EU) directives; Common Market for Eastern and Southern Africa (COMESA); West African Economic and Monetary Union/Union Économique et Monétaire Ouest-Africaine (WAEMU/ UEMOA)

United Nations Commission on International Trade Law (UNCITRAL) Model Law and the Asia-Pacific Economic Cooperation (APEC) Nonbinding Principles, as well as guidelines of lending agencies, play important roles in setting out international norms for reforming domestic procurement frameworks.⁸

The APEC principles, as stated in the 1994 Bogor Declaration, include a transparency standard, value for money, open and effective competition, accountability and due process, fair dealing, and nondiscrimination. These principles are similar to the objectives, whether binding or nonbinding, enunciated in other international instruments, including the WTO's Government Procurement Agreement (GPA). All international frameworks stress the importance of transparency and an optimal use of resources and acknowledge the need for nondiscrimination and competition in procurement markets, within a rules-based procurement system. The nonbinding principles cannot, however, provide any significant degree of legislative push or legislative certainty.

PTAs with government procurement provisions have similar general objectives, but PTA negotiations, particularly among similar countries, can allow for the provisions to be better tailored to parties' needs. Parties to a PTA may share cultural interpretations of principles such as fairness, accountability, and integrity, and the consequent ability of a PTA to promote the harmonization of procurement rules may enable bidders to better predict methods of tendering, selection, and adjudication, thereby increasing the efficiency and competitiveness of the system. There is, however, a risk of creating a patchwork of different pro-

urement processes internationally, reducing transparency and competition.

A government procurement provision may be explicitly discriminatory, but this does not imply that the implementation of the provision is necessarily harmful to the commercial interests of third parties. Indeed, many provisions in PTAs require changes in national procurement regimes that, as a legal matter, need only be shared with signatories. If, however, operating dual administrative systems is very costly, a signatory may decide that it is cheaper to share all the PTA-induced improvements with all of its trading partners. In that case, the agreement may allow *de jure* discrimination with respect to a particular provision, but, *de facto*, no discrimination occurs. This observation does not imply that there is no discrimination in the public procurement provisions in PTAs but, rather, that it is possible for a discriminatory provision to generate most favored nation (MFN) benefits. Put simply, criticism of PTAs on the basis of the effects of discriminatory tariff reforms need not carry over to public procurement provisions. Again, straightforward generalizations may not be possible.

Just because a PTA contains potentially discriminatory provisions does not imply that its implementation will cause harm to nonsignatories; a PTA may trigger MFN improvements in public procurement institutions. It would also be wrong to infer that because a national procurement regime could be improved, PTA provisions are the best vehicle for doing so. Open-minded, case-by-case assessments of the merits of such provisions are probably the best counsel for policy makers and those that advise them.

Finally, reverting to the earlier discussion, individual governments' preferences as to the objectives of procurement vary. Procurement provisions negotiated in a PTA should reflect both agreement on policy-neutral ways to achieve better regulation (such as transparency) and some degree of acceptable exceptionality that can be accommodated through specific exceptions or exemptions, as discussed in the next section.

An Overview of Government Procurement Provisions in PTAs

Surveys of government procurement provisions in PTAs worldwide indicate that these regimes exhibit a wide variety and may overlap (Bourgeois, Dawar, and Evenett 2007; Dawar and Evenett 2008). The most comprehensive regimes—for example, the PTA between the EU and Chile, the North American Free Trade Agreement (NAFTA), and the Dominican Republic–Central America Free Trade Agreement (CAFTA–DR) PTA—contain detailed provisions on government procurement and related issues, such as dispute settlement. At the other end of the spectrum, some PTAs omit procurement altogether; examples are the East African Community (EAC) and the Association of Southeast Asian Nations (ASEAN). Other agreements set out minimal provisions covering only transparency, cooperation, or the gradual liberalization of procurement markets.

The variety of regimes largely stems from the fact that government spending is the preserve of sovereign decision making, providing a readily available (but not necessarily effective) tool for favoring particular domestic policies, sectors, or communities. Consequently, the willingness of governments to use PTAs to reform, or to codify the reform of, public purchasing practices depends on national circumstances and international opportunities. Policy makers have many options available to them as they consider their country's strategy toward government procurement provisions in PTAs. Where governments have been proactive, significant provisions have been developed, as discussed next.

Examples of Government Procurement Provisions in PTAs

The most comprehensive government procurement agreement to date is the Australia and New Zealand Government Procurement Agreement (ANZGPA). The general principle behind this agreement is to form a single government procurement market “to maximise opportunities for competitive [Australia and New Zealand] suppliers and reduce costs of doing business for both government and industry.” The procurement provisions are designed to

ensure that both parties' suppliers are given equal access to each others' government procurement markets.

EU and U.S. PTAs with industrial economies such as Chile and Australia, although regarded as relatively comprehensive, are less ambitious regarding market access, containing instead general principles of nondiscrimination, reciprocity and transparency.⁹ The economic partnership agreement (EPA) between the EU and the Caribbean Forum of African, Caribbean, and Pacific (ACP) States (CARIFORUM) is unique in including only transparency as a general principle, without any binding commitments regarding market access.

The U.S.–Jordan PTA contains a single commitment on government procurement, to the effect that the parties support Jordan's accession to the WTO Government Procurement Agreement. This clause could promote the market access interests of both parties and of all existing members of the GPA. So far, PTAs entered into by the EU have not included clauses committing a party to accede to the GPA. Instead, their negotiated texts tend to set reciprocal and gradual liberalization of procurement markets as a goal without specifying the scope or coverage of the agreement. This is the case with the EU–Morocco association agreement, which states that the council set up by the agreement must implement the mutual opening of procurement markets.¹⁰

To make the picture even more varied, not all industrial countries have chosen to include government procurement provisions in their agreements, as illustrated by the Canada–Costa Rica and New Zealand–China PTAs. South-South PTA provisions also vary widely. In ASEAN, the EAC, and the Southern Cone Common Market (Mercosur, Mercado Común del Sur), for instance, no government procurement provisions have been negotiated, whereas in the CAFTA–DR agreement, the general principles accord national treatment and nondiscrimination to all parties to the PTA. In the Common Market for Eastern and Southern Africa (COMESA), the guiding principle is to promote regional procurement integration through cooperation and information exchange rather than through binding procurement laws.

Defining the Scope of Government Procurement Provisions in PTAs

Most PTAs that include government procurement provisions tend to follow the WTO GPA positive-list approach. This means that the scope of the provisions is defined during the negotiations, and the obligations apply only to procurements by the entities listed in the annexes to the text. (In the GPA, the relevant provisions are Annexes 1–3

to Appendix I.) The positive-list system allows for greater national flexibility and a more incremental approach to procurement reform for the included entities. For example, NAFTA only regulates federal or central government enterprises and certain parastatals.¹¹ State and provincial government entities are excluded, although the governments “encourage” voluntary and reciprocal participation by their respective subnational units. The PTA between the EU and Chile includes a positive list for the European federal entities covered for each EU member state. Although most member states also follow a positive-list approach at the subnational level, some EU members, such as Finland, have chosen to employ a negative-list approach, which means that, except as explicitly specified, all public or publicly controlled entities or undertakings that do not have an industrial or commercial character are subject to the government procurement provisions. Chile, by contrast, follows a strict positive list for both central and municipal levels.

The negative-list approach is used most notably in the deep integration PTA between Australia and New Zealand: all government entities are subject to the procurement obligations except those that are explicitly listed as exempt. This broad approach complements the objectives of the Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), of creating a single market between the two parties and achieving the maximum benefits from bilateral trade. The choice of a negative-list approach to negotiations on the entities covered by government procurement provisions is typically taken to signal greater liberalizing ambition. The total amount of commercial opportunities created depends, however, on a wider range of factors.

Following the WTO GPA approach, and mirroring its text, the EU–Chile obligations apply to “any law, regulation, procedure or practice regarding any procurement, by the entities of the Parties, of goods and services including works, subject to the conditions specified in the relevant Annexes.”¹² As with the WTO GPA and most PTAs, the EU–Chile obligations do not apply to some kinds of contracts, including international agreements; contracts pertaining to land acquisition, broadcasting, arbitration, employment, and financial services; and certain research and development (R&D) contracts. U.S. PTAs, the ANZGPA, and the WTO GPA include both goods and services and, most notably, big-ticket items such as construction services.

Thresholds

The coverage of government procurement provisions in a PTA applies only if the value of the procurement is at or

above the thresholds negotiated by the parties. To the extent that other PTA provisions limit or condition discrimination, the thresholds agreed in a PTA have an important effect on the extent to which domestic firms will face additional competition from foreign rivals after the PTA comes into effect.

Thresholds may differ according to the type of procurement and the level of government making the purchase. In effect, these thresholds allow for a partial opening up of the covered sectors, offering governments flexibility to promote other policy objectives through certain excluded sectors of the procurement market. Using thresholds to promote an incremental approach to reform extends shelter from these obligations to sectors and entities operating below the threshold. The provisions of the EPA between the EU and CARIFORUM, for example, apply only to central government contracts in excess of one of the highest thresholds yet negotiated, US\$200,000.

Notwithstanding the need to tailor procurement provisions to the domestic circumstances of a country, a cost-benefit analysis of high thresholds and preferential policies is essential. Such analyses, however, are scarce. As was noted above, using discriminatory procurement as a development tool detracts from the beneficial effects of applying value-for-money criteria to the expenditure of public funds. These benefits are usually sought in the most integrated PTAs, such as the ANZGPA, which, consequently, do not set any thresholds.

Countries that are parties to PTAs and are also members of the WTO GPA cannot set higher thresholds in bilateral and regional agreements involving other GPA members than those stated in the GPA. That agreement’s thresholds vary according to level of government (central government, subcentral government entities, and government-owned enterprises) and are expressed as special drawing rights (SDRs), an accounting unit used by the International Monetary Fund (IMF).¹³ In order to capture further benefits from liberalizing procurement markets, the more recent U.S. agreements (except those with Bahrain and Morocco) have negotiated thresholds lower than those agreed to in the GPA.

Incorporating Development or Domestic Policy Objectives

To afford further flexibility in implementing government procurement provisions, parties to PTAs with government procurement regimes may negotiate specific exceptions in the scope or coverage of the agreement (see box 17.3). Most of the more comprehensive agreements explicitly prohibit government entities from imposing measures aimed using requirements regarding domestic content,

Box 17.3. Examples of Flexible Provisions in Government Procurement PTAs*Scope: Level of entities covered by the provisions*

- Central or federal level only: U.S. preferential trade agreements (PTAs); set to commitments in the World Trade Organization (WTO) Government Procurement Agreement (GPA)
- Subcentral entities: European Union (EU) PTAs; set to WTO GPA commitments
- All entities: Australia and New Zealand Government Procurement Agreement (ANZGPA); New Zealand–Singapore PTA

Thresholds: Minimum value at which procurement is covered by provisions

- WTO GPA thresholds or lower: GPA parties
- Transitionally higher than WTO GPA thresholds: PTAs between the United States and Bahrain, the United States and the Dominican Republic–Central America Free Trade Agreement (CAFTA–DR), and the United States and Oman
- Higher than WTO GPA thresholds: economic partnership agreement (EPA) between the EU and the Caribbean Forum of African, Caribbean, and Pacific (ACP) States (CARIFORUM)
- No thresholds: ANZGPA; New Zealand–Singapore PTA; Chile–Costa Rica PTA

Exclusions

- Defense procurement
- Transport: U.S. PTAs
- Financial services: Chile PTAs (e.g., U.S.–Chile; Mexico–Chile)
- Health, education, and welfare: New Zealand (e.g., Trans-Pacific Strategic Economic Partnership)

Set-asides

- Preferential opportunities for indigenous persons: Australian agreements (e.g., Singapore–Australia PTA, Article 15)
- Small and minority businesses: U.S. general note to annexes

Offsets

- Prohibited: U.S.–Singapore, Japan–Switzerland, EU–Chile, and other PTAs
- Not prohibited: EU–CARIFORUM EPA, European Free Trade Association (EFTA), Singapore–Australia PTA, EU–Jordan PTA, and others

licensing of technology, investment, and the like to encourage local development or improve balance of payments accounts. These measures are known as offsets and are defined in Article XVI of the WTO GPA. There are, however, other measures that give the parties flexibility to promote domestic policy objectives. For example, under NAFTA's joint programs for small business, a committee is established to report on the efforts being made to promote government procurement opportunities for members' small enterprises. NAFTA also initially allowed Mexico's national oil and electric companies to set aside one-half of their procurement each year for domestic suppliers. (This provision was entirely phased out by 2003.) Unlike the United States and Canada, Mexico is not a member of the WTO GPA, and its procurement is therefore subject only to the obligations negotiated in PTAs. Another NAFTA exception allowed Mexico to impose local-content requirements for turnkey construction projects. For capital-intensive projects, Mexico negotiated set-asides for as much as 25 percent for local inputs, and for up to 40 percent Mexican content for labor-intensive projects.

In the free trade agreement (FTA) between Mexico and Nicaragua, in addition to set-asides, both parties

negotiated rules allowing minimum local-content rules for awardees of state contracts. Such provisions are not confined to South-South arrangements. Promotion of the development of local industry and local employment is included in the Australia–Singapore FTA, which explicitly allows the Australian government to promote employment for significant indigenous communities.

In addition to provisions allowing for set-asides and other exceptions, cooperation and technical assistance can also be specified in the agreement. For instance, the EU–Chile government procurement provisions state that the parties will seek to provide technical assistance on issues connected with public procurement, paying special attention to the municipal level. The North-South EU–CARIFORUM agreement includes provisions on cooperation and technical assistance, with commitments of financial resources. There are also asymmetrical requirements that the EU show “due restraint” in resolving disputes in favor of CARIFORUM parties. This is ambiguous, but it could result in the EU's resolving disputes by giving the CARIFORUM partners the benefit of the doubt, or demanding less retaliation. The agreement also allows a significant implementation period to give CARIFORUM

countries ample time to prepare for implementation and provides for development support.

In addition to exceptions in individual schedules, procurement obligations in U.S. PTAs (like those of the WTO GPA) are subject to national security and general exceptions, to exclude sensitive sectors from the overall rules. These exceptions vary in their scope and details. The U.S. PTAs with Chile and Singapore include “essential security” provisions specifically applicable to government procurement obligations, but this type of national security exception is not present in the U.S.–Morocco and U.S.–Australia agreements. In general, the government procurement exceptions in the EU’s PTAs broadly follow the template contained in Article XX of the General Agreement on Tariffs and Trade (GATT); Article 161 in the EU–Chile PTA is an example. U.S. PTAs are different in that they include additional specific measures, such as those necessary to protect human, animal, or plant life or health (e.g., U.S.–Chile PTA, Article 9.16).¹⁴

Settling Disputes over Government Procurement in PTAs

An effective dispute resolution mechanism is critical to the effectiveness of government procurement disciplines in PTAs. It also has broader application because government procurement dispute settlement provisions include a number of features that might usefully be employed in other behind-the-border policies (see Porges, ch. 22 in this volume).

Within a comprehensive PTA government procurement regime, there can be two or possibly three levels of dispute settlement. The first level consists of the procedures and institutions governing disputes between the procuring entity and a disappointed bidder (the disputes being those relating to the procurement procedure itself). The second level is the system governing disputes between the parties to the agreement—that is, state-state disputes regarding compliance or the implementation of the government procurement provisions within the agreement. At the third level, there may be a clause governing disputes between state parties that are simultaneously members of other relevant international agreements with overlapping jurisdictions that also include dispute settlement mechanisms.

Complaints about the procurement process. The availability of dispute settlement of complaints matters because it means there is a self-policing and self-enforcing mechanism for the procedural provisions set out in an agreement.¹⁵ A dispute settlement mechanism provides an essential forum for airing complaints and obtaining relief, and it offers the parties due process rights while enhancing

the accountability of the officials and the procuring agencies. The existence of the mechanism improves the system’s reputation, reducing barriers to entry caused by a poor perception of the integrity or due process of procurement markets. An important point is that complaints do not concern the performance of the contract, once it has been initiated. (That type of performance complaint is covered in the contract itself.)

Domestic review mechanisms can be located within a contracting agency, a dedicated independent entity, or the general court system. Each option has advantages and disadvantages relating to issues such as perceived independence, expertise, efficiency, and authority. A common model used in the more comprehensive PTAs is to house the bid challenge mechanism in a designated body or agency. A deep integration model such as the ANZGPA typically embeds the monitoring procedures in an annex to the agreement. The annex then commits the parties to identify a designated body as the responsible authority and point of contact for complaints. Monitoring is triggered by the examination of alleged breaches of the agreement by the other party. The designated body investigates the complaint, and if the matter cannot be resolved, it has the power to refer the case to the ministerial level for further investigation, if necessary. This is a very streamlined model that is able to balance the lack of formal procedures with speed and efficiency and is mainly suitable for more highly integrated markets.

The NAFTA bid challenge system is much more procedurally extensive. It obligates the parties to adopt and maintain bid challenge procedures that allow suppliers to submit challenges concerning any aspect of the procurement process. It seeks to ensure that the contracting entities accord fair and timely consideration to any complaint and sets out minimum time limits for the submission of complaints. Independent reviewing authorities must be identified, and the “entities normally shall follow the recommendations of the reviewing authority” for bringing the actions into conformity with their obligations.

A similar template obligating the parties to provide procedures that are transparent, timely, impartial, and effective can be found in the CAFTA–DR, EU–Chile, U.S.–Chile, and EU–CARIFORUM agreements. Most of these agreements do not specify the measures available for remedy of breaches or the amount of compensation. The EU–Chile agreement, for example, states that the challenge procedures shall provide for correction of breach of the provisions or for compensation for damages, which is limited to the costs of tender preparation and protest. The government procurement provisions in the EU–Mexico FTA

concerning the gradual and reciprocal liberalization of signatory procurement markets are less ambitious, and the challenge procedures are correspondingly less well developed. The agreement simply states that the PTA's joint council should decide on the construction of "clear" challenge procedures.

As a model for some of the more comprehensive PTA provisions, Article XX of the WTO GPA, on challenge procedures, includes similar language concerning first-instance consultation procedures, transparency and good governance of the review proceedings, and time limits. The article further states that the review body should be a court or impartial entity subject to judicial review or similar procedures. The challenge provisions include the option of taking rapid interim measures to correct breaches of the agreement and limitation of compensation for damages suffered to the costs of tender preparation or protest.

Those PTAs that have soft cooperation provisions covering government procurement or best-endeavor clauses do not include bid challenge mechanisms because these are to be developed within domestic legislation. Where review mechanisms are included in such agreements, they necessarily apply only to procurement that lies within the scope and coverage negotiated by the parties.

Existing approaches in state-state disputes. Where neither party to a PTA is a member of the WTO GPA, disputes about nonimplementation of the government procurement provisions are governed only by the PTA itself. This is the case, for instance, with ANZCERTA, the deep integration PTA between Australia and New Zealand. No specific procedure is established to govern disputes related to noncompliance of government procurement provisions; instead, the agreement states that "the close and long-standing political relationship between Australia and New Zealand means that any issues of grievance or concern are addressed through discussion between the two Governments."

NAFTA's dispute resolution provisions are applicable to all disputes regarding the interpretation of application of NAFTA and are "intended to resolve disputes by agreement, if at all possible." Because the process encourages the use of arbitration for settlement of disputes between parties, it begins with government-to-government consultations. When these general disputes are not resolved through consultation within a specified period of time, either party can request that the dispute be referred initially to the "good offices" of NAFTA's Free Trade Commission. If the dispute is not resolved within a fixed time period, the matter can be referred to a panel for ad hoc arbitration. Each party selects two panel members, and the chair is chosen by consensus. The panel's recommenda-

tions are binding. Thus, in comparison with integrated systems such as those of the EU, EFTA, or COMESA, which have permanent international courts to settle disputes between member states, individuals, and the organization's institutions, NAFTA is less institutionalized and relies mostly on ad hoc arbitration and diplomacy.

The state-state dispute settlement provisions in the U.S.–Chile and CAFTA–DR agreements have a similar framework, typically reflecting the multimember nature of the PTAs. Both sequence dispute settlement procedures in the same manner, although the CAFTA–DR PTA has an additional provision allowing for multiple complainants and third-party participation in dispute proceedings and setting out different procedures. Under this agreement, a party that considers it has a substantial trade interest in a dispute between other parties to the agreement may participate after sending a written notice explaining its interest in the matter to the other parties within seven days of delivery of the initial request for consultations (Article 20.4, on consultations). That party automatically becomes one of the consulting parties and may request a meeting of the agreement's commission if the matter is not resolved within a specified time.

Overlapping jurisdictions and dispute settlement mechanism "shopping." Article XXII of the WTO GPA, on consultations and dispute settlement, provides that the WTO Dispute Settlement Understanding (DSU) applies if a GPA party considers that an objective of the agreement or a benefit accruing to the party from the agreement is being nullified or impaired because another member has failed to carry out its obligations. The Dispute Settlement Body (DSB) has the sole authority to establish panels of experts to consider the case and to accept or reject the panels' findings or the results of an appeal. It monitors the implementation of the rulings and recommendations and can authorize retaliation when a country does not comply with a ruling. The DSB's recommendations are to be implemented, and the relevant party must state its intention of doing so at a DSB meeting held within 30 days of the report's adoption. If it does not, the complaining side may ask the DSB for permission to impose limited trade sanctions against the noncompliant party; these sanctions are ideally restricted to the same sector as the nullification or impairment.

Because of its legalistic and binding framework, the DSB is one of the strongest trade arbitration forums. Its strength makes it attractive to weaker states that are unable to exert diplomatic pressure on a noncompliant party. But a lack of coherence in international trade law can result when governments are faced with multiple and overlapping obligations and jurisdictions to choose from when trying to settle a dispute.

To offer more predictability and transparency, some PTAs include rules that dictate the choice and sequencing of dispute settlement systems. In some PTAs, a request for the establishment of a WTO panel excludes the jurisdiction of the regional forum, or the use of one mechanism excludes the use of another (to prevent “forum hopping”). A PTA cannot take away the jurisdiction of the WTO GPA: if a party to both a PTA and the GPA appeals to the WTO Dispute Settlement Body, the panel will not refuse it because of PTA rules. (The panel will, however, refuse the dispute if it does not concern the application of the GPA or another WTO agreement.)

The U.S.–Chile and CAFTA–DR PTAs have clauses clarifying the forum to be used in a dispute. A complaining party may select the forum, which may be either the PTA concerned, another PTA to which the parties are party, or the WTO DSM, as appropriate. Once the party requests a panel under the jurisdiction of one agreement, the forum selected is to be used to the exclusion of others.

The arrangement in the EU–Chile agreement is more elaborate: it provides that unless the parties agree otherwise, when a party seeks redress for a violation of an obligation under the forum exclusion clause (which is equivalent in substance to an obligation under the WTO), it shall have recourse to the relevant rules and procedures of the WTO Agreement, which apply notwithstanding the provisions of the PTA. Once dispute settlement procedures have been initiated in a selected forum, that forum is to be used to the exclusion of any other

NAFTA’s members are the United States and Canada, which are parties to the WTO GPA, and Mexico, which is not. In the case of a dispute relating to procurement between the United States and Canada, those countries can choose whether to use the PTA or the WTO forum. Mexico’s procurement is exclusively governed by NAFTA, and so it must adhere to the procedures specified in that agreement.

The NAFTA dispute settlement procedures are oriented toward diplomatic or negotiated solutions. They provide that disputes regarding any matter that arises under both NAFTA and the General Agreement on Tariffs and Trade (GATT), or under any agreement negotiated under these arrangements, or under any successor agreement, may be settled in either forum at the discretion of the complaining party. A party is to notify any third party of its intention to bring a dispute, with a view to agreement on a single forum. If the parties cannot agree, the dispute is normally to be settled under the NAFTA procedure. This has led in the past to some danger of legal fragmentation, as can be seen in the U.S.–Mexico soft drinks dispute, when Mexico tried to bring a NAFTA dispute to the WTO on the

grounds that the United States refused to form a panel to settle the dispute under NAFTA. The WTO Dispute Settlement Body declined jurisdiction because the dispute did not fall within the scope of the WTO agreements.

Clearly, parties tend to choose the recourse most likely to generate a favorable outcome for themselves. The variables considered will include the scope and legal status of the measure in dispute; the applicable law; the procedures, structure, and time frame of each mechanism; the remedies available; and the inherent characteristics of each dispute settlement process. That is, consideration of the political circumstances of the dispute can also influence its resolution, as is seen in the dispute between Mexico and the United States over soft drink sweeteners (for background, see Davey and Sapir 2009).

Costs of Implementing Government Procurement Provisions

Information on the costs of implementing government procurement provisions in PTAs is scarce.¹⁶ Still, enough is known about the content of potential PTA provisions that some tentative observations can be made about the nature and extent of these costs.

Setting up an effective government procurement regime requires specialized institutional frameworks and expertise. Although the economic and welfare benefits to be gained from fair and transparent procurement markets are likely to be sizable as a share of the total amount spent on goods and services by the government, the procedures and challenge mechanisms which enable bidders to feel confident that procurement processes are fair and transparent will require resources. The implementation of a PTA, however, does not necessarily entail new costs, as the government may have borne some or all of these costs beforehand. What share of additional implementation costs is PTA-specific is an open, factual question, the answer to which is likely to differ according to the country and the preexisting procurement regime.

Implementation costs are likely to vary across government procurement provisions. For example, transparency provisions that require signatories to publish all relevant procurement regulations in a foreign language will require translators with legal expertise, and retaining the specialized legal talent to adjudicate complaints on procurement matters and present appeals before tribunals is a distinct resource challenge. The nature and timing of implementation costs will thus differ among classes of government procurement provisions and capacity-building needs.

The costs associated with setting up an effective national procurement system are usually borne by the

jurisdiction concerned. The review of PTAs in this section indicates that no regional institutions had to be created to implement any of the agreements. Even in the PTAs with the most comprehensive government procurement commitments, the institutional implications are all at the national level. This contrasts with regional competition regimes that have established a regional competition law and a competition authority to monitor the implementation of the provisions (see Dawar and Holmes, ch. 16 in this volume). Although setting up an effective and transparent government procurement system is costly, there are no further costs for establishing and running the regional procurement institutions provided for in these PTAs. This is so even in the case of the deepest government procurement integration framework, the ANZGPA between Australia and New Zealand. The implementation of the agreement relies on existing national bodies, and no supranational institutions need to be established. The agreement contains the monitoring requirement that each jurisdiction must have at least one designated body to be the point of contact for complaints, with the authority, responsibility, and expertise to handle and investigate complaints across government and public sector agencies covered by the agreement. If the complaint is multijurisdictional, all the relevant designated bodies and, where necessary, ministers are included in the procedure.

Similarly, the CAFTA–DR procurement regime includes commitments to establish or designate at least one impartial administrative or judicial authority, independent of procuring entities, to receive and review challenges by suppliers relating to the obligations of the party. Again, this bid challenge mechanism is to be established at the national level and does not entail any institutional buildup, assuming that there is already a domestic institution for reviewing domestic complaints. The same is true of those PTAs with provisions that are restricted to ensuring transparency in government procurement, such as the EU–CARIFORUM agreement. Each party must identify or designate at least one impartial administrative or judicial authority that is independent of its procuring entities to receive and review challenges by suppliers arising in the context of covered procurement.

In the case of the U.S.–Jordan agreement, the institutional implications are broader than a commitment to establish national procurement institutions to implement the obligations of the PTA. Article 9 of the agreement states that, pursuant to Jordan’s application for accession to the WTO GPA in 2000, the parties shall enter into negotiations with regard to Jordan’s accession to the WTO GPA. The GPA requires that a committee on government procurement, composed of representatives from each the party, be

established. This committee is to meet as necessary, but not less than once a year. It may establish working parties to carry out specific functions. Jordan’s decision to accede to the GPA, however, was made independently and before the agreement with the United States.

In sum, much of any burden of implementation of PTA obligations is borne at the national (and, potentially, subnational) levels. But there is another significant opportunity cost that some governments may perceive from signing government procurement provisions: constraints on the use of state spending as an “industrial policy” tool for promoting targeted industries.¹⁷ This is not the place for a full exposition on industrial policy; suffice it to say that assertions about the implications of government procurement reforms for such policies have been made in both developing and industrial countries. An important question is whether public procurement policies optimally target whatever market failure is holding back the industries in question.

Technical Assistance

Technical assistance requirements related to government procurement in PTAs may be quite substantial. For example, NAFTA requires the parties to provide, on a cost-recovery basis, information concerning training and orientation programs relevant to their government procurement systems and to grant nondiscriminatory access to any programs they conduct. Such activities include training of government personnel directly involved in government procurement procedures; training of suppliers interested in pursuing government procurement opportunities; an explanation and description of specific elements of the party’s government procurement system, such as its bid challenge mechanism; and information about government procurement market opportunities. NAFTA parties are also required to establish at least one contact point to provide information on the training and orientation programs. These NAFTA provisions are much more extensive than the analogous obligations in other PTAs. For instance, the EU–Chile PTA states only that the parties will seek to provide technical assistance on issues connected with public procurement, with special attention to the municipal level.

For PTA developing-country members that are also signatories of the WTO GPA, the technical assistance provisions are more substantive than at the regional level. Article V of the GPA, on special and differential treatment for developing countries, states that each developed-country party shall, on request, provide all the technical assistance which it may deem appropriate to developing-country parties to help resolve their problems in the field

of government procurement and that this assistance must be provided in a nondiscriminatory way. Assistance is to be directed toward the solution of particular technical problems relating to the award of a specific contract and is to include translations into an official WTO language of qualification documentation and of tenders made by suppliers of developing-country parties. Developed-country members are required to establish, individually or jointly, information centers to respond to reasonable requests from developing-country parties for a variety of specified procurement information.

Government Procurement Provisions in PTAs in a Multilateral World

In assessing the trade-negotiating options facing a government in the area of government procurement practices, it is commonplace to compare nondiscriminatory PTA options with multilateral reform conducted on an MFN basis. Such assumptions, however, should not always guide policy advice in the government procurement arena, precisely because the GPA is a plurilateral accord that extends “concessions” only to other signatories to that accord. As far as market access is concerned, there is no nondiscriminatory multilateral benchmark to rely on, and as long as the national institutions associated with implementing public procurement are exempted from the WTO’s national treatment provisions, there is no multilateral benchmark there, either.

The absence of benchmarks does not imply that pursuit of nondiscriminatory reform through a trade agreement is impossible. At present, such reform can take place unilaterally or, somewhat paradoxically, in the context of a preferential PTA. In the future, however, should WTO members extend traditional nondiscriminatory disciplines on a multilateral scale, another means of liberalizing public purchases on an MFN basis will become available. With these remarks, it should be clear that any analogies between tariff reform strategies and public procurement reform strategies in the context of trade agreements have to be drawn very carefully. Blanket application of the logic of the former to the latter is likely to be misleading.

Theoretical versus Actual Costs of Discrimination

There are theoretical reasons why provisions on government procurement in PTAs could be discriminatory. First, as in any situation in which a buyer has market power—as some state buyers with large budgets might—discrimination against certain suppliers can, in principle, reduce the costs to the purchaser. In the context of government procure-

ment, as in other situations of less-than-perfect competition (see Baldwin, ch. 3 in this volume), deviations from free trade could theoretically be welfare improving. For instance, imposing price preferences on foreign suppliers (i.e., raising their bids by a certain percentage) will induce them to lower their bids for state contracts. If enough of those foreign suppliers enjoy a cost advantage over their domestic rivals, the probability that a foreign supplier could still win the contract may be high enough that the expected cost of the government procurement will fall. In these circumstances, promoting a level playing field may not necessarily be welfare maximizing. Yet, the lack of capacity to collect and analyze the necessary information to discriminate optimally between suppliers calls into question whether a state purchaser could in practice tap the gains from exploiting its buying clout. Moreover, as Deltas and Evenett (1997) show in a series of simulations of procurement bidding situations, the gains from discrimination may be small (when expressed as a percentage of the purchase price), and even tiny mistakes in setting the optimal degree of discrimination could result in increased, not reduced, procurement costs. All in all, a rule of thumb of open competition is recommended to policy makers. This implies opening up state procurement contracts to the maximum number of appropriately qualified bidders.

Second, traditional concerns related to PTAs about the risk and cost of trade diversion could also apply to the preferential liberalization of government procurement in these agreements. Whether trade is diverted from efficient to less-efficient foreign suppliers will depend on the treatment of foreign bids before the PTA was concluded. If bids from foreigners were allowed and price preferences were applied on an MFN basis before the PTA was enacted, the traditional concerns about trade creation and trade diversion arise.¹⁸ By contrast, if no bids from foreign firms were allowed before the PTA was signed, the additional competition for state contracts is likely to push down the price paid by the public buyer, and there was no trade to divert in the first place. Overall, this suggests that if a PTA generates, for the first time, significant foreign competition for state contracts, there are likely to be economic benefits in the form of lower procurement costs. For procurement regimes that already benefit from considerable foreign competition, the benefits of preferential reform through PTAs may be ambiguous and even adverse.

A third consideration is that there are various forms of discrimination in government procurement systems against foreign bidders. Simulations have been conducted of the increases in procurement costs created by price preferences, by measures that raise the costs of foreign bidders, and by outright limitations on the number of foreign bidders.

Although these simulations do not claim to have covered every single case or procurement setting, price preferences were found to inflict the least harm, and cost-raising measures were the next least harmful. Given these findings, it is paradoxical that discrimination through price preferences is most often singled out for banning in PTAs. A perhaps preferable alternative might be to eliminate or limit the other forms of discrimination, even if it comes at the expense of higher price preferences, at least initially.¹⁹

Transparency and Third-Party MFN

The implementation of PTA provisions that improve the transparency of government procurement procedures (on the plausible assumption that the entry of both domestic and foreign firms is encouraged by such improvements) may lead to either reductions or increases in the share of state contracts awarded to foreign firms (Evenett and Hoekman 2005). There is some evidence that small and medium-size enterprises are more sensitive to the transparency of national procurement regimes, in which case PTA-induced improvements in transparency may increase the proportion of state contracts awarded to a class of firms that governments, for other reasons, typically wish to favor.

The example of implementation of improvements in transparency on an MFN basis carries over to other PTA-induced improvements in public procurement regimes that are implemented on a nondiscriminatory basis. One might ask why a government would voluntarily extend benefits to non-PTA signatories.²⁰ The answer is that the implementation costs of operating two or more procurement regimes for different trading partners may exceed the cost of operating a single reformed regime. Indeed, consistent with the literature on multilateralizing regionalism (e.g., Baldwin and Low 2009), it is possible that a PTA can induce in a signatory an institutional innovation or improvement that is willingly shared with all trading partners. Again, concerns about the inherently discriminatory nature of PTAs must be tempered. The fact that certain PTA provisions on public procurement are written in a discriminatory manner does not mean that they are so implemented or that the net effect of all the PTAs provisions is to limit the commercial opportunities of nonsignatories.

There may, however, be more subtle intertemporal relationships between PTA provisions on government procurement and nondiscrimination. The use of third-party MFN clauses is a case in point. Under such a clause, should A, a party to a PTA with B, subsequently sign another PTA with a third party, C, and in so doing offer C better access to A's government procurement market than B, then B is entitled to the same access as C.²¹ (The better market access

here could relate to more contracts, lower price preferences, lower thresholds, and so on) The use of such a provision would ratchet up the degree of competition over time in government procurement markets while simultaneously ensuring that all beneficiaries of this clause fight for contracts on the same terms (limiting discrimination between PTA signatories.) Third-party MFN provisions do not, of course, limit discrimination against exporters from countries that have not signed a PTA, so it would be wrong to conclude that they eliminate all forms of discrimination across trading partners.

Because of the potential confusion regarding third-party obligations in future PTAs, it is becoming more common to clarify these issues of overlapping PTA membership and jurisdictions within the agreement itself. Government procurement provisions in the more comprehensive PTAs aim to open public procurement to foreign competition on a preferential basis. In order to protect these preferences, some procurement provisions require third-party MFN guarantees so as to limit the extent to which preferential procurement is undermined by subsequent PTAs.²²

Third-party MFN clauses that extend preferential access automatically reduce the geographic discrimination implied by proliferating PTAs. They also allow a government to free ride on the negotiating clout of their PTA partners in future agreements: countries with relatively small procurement outlays can choose to negotiate for the inclusion of these provisions if it seems that the other party may subsequently negotiate an agreement with a larger country. Albania, the former Yugoslav Republic of Macedonia, and Turkey have in the past included third-party MFN provisions and have followed this strategy.

It should be noted that the arguments reviewed above are based on economic principles and evidence from simulations of procurement auctions. We do not know of a single econometric analysis that seeks to estimate the effect of implementing the government procurement provisions of a PTA.²³ Policy makers and readers should bear this in mind when assessing the above arguments.

Relationship to Open Regionalism

Some experts, recognizing the pervasive nature of PTAs, have argued that their discriminatory impact might be limited if terms could be defined *ex ante* under which nonsignatories could enter a trade bloc. Clarity of terms of entry and the desire to limit the loss of commercial opportunities from being outside a bloc are said to encourage entry and, ultimately, to expand the amount of trade conducted under freer, if preferential, terms. In principle, the

key ingredients for such open regionalism to work are present in the context of PTA provisions on government procurement, as long as these provisions are implemented on a nondiscriminatory basis.

Yet, it could be that the preferential trade-related government procurement accord most likely to induce entry is the WTO's plurilateral GPA, which now has 40 members. Existing GPA members are unlikely to offer more market access to a new member (so, the terms of entry are clear), and the scope of public procurement covered in the GPA is greater than under any existing PTA. This is not to say that open regionalism could not happen anywhere else but only that it would be strange to see such developments happening outside the WTO when the WTO accord provides the greatest incentives to join. If that logic is to be taken seriously, the best hope for open regionalism is probably open plurilateralism. Then, the provision of the U.S.–Jordan PTA that supports Jordan's accession to the WTO GPA could be seen to promote open regionalism and open plurilateralism most directly.

Implications for Trade Negotiating Strategy and for Evaluation of Policy Options

In recent years, more and more PTAs have included provisions on government procurement, ranging from transparency-only clauses to the creation of a single regional procurement market. These provisions affect an important area of state behavior—public purchasing—and there is, no doubt, interest in their potential development impact. The word “potential” is used deliberately because policy makers, officials, and analysts would be wise to differentiate between what has been done and what could be done. Arguably, this is an area of trade policy making in which, at present, the former is far from approaching the latter.

For many countries, government procurement outlays are a sensitive matter, at least in terms of interest groups and politics. The desire for value for money in public purchasing has often been tempered by support for favored industries and groups. This has complicated but has not precluded the negotiation of government procurement provisions in PTAs, often with the full range of exceptions and other devices used to limit the impact of such provisions. Procedures to review the cost of those exceptions and to suggest alternative measures of helping favored industries should be given greater consideration in the future.

More generally, many of the rules of thumb that trade economists have developed concerning the relative efficacy of different tariff reform strategies do not carry over to public procurement reforms. Evaluations of public policy

options should not be approached dogmatically. Rather, a case-by-case evaluation is appropriate, taking due account of the state of national purchasing practices before any reform was launched. For example, PTA provisions that call for improvements in transparency should be treated differently from those relating to market access. Moreover, pointing to WTO obligations as a nondiscriminatory benchmark is not an accurate reflection of the existing state of that organization's plurilateral accord. Even more confusingly, the tension between discrimination and liberalization in PTAs may not be as relevant for public procurement as it is for tariffs.

Policy analysts would do best to understand, first, national procurement regimes and, second, the potential sources and magnitudes of benefits from reform. Then, consideration should be given to which reform vehicle (unilateral, bilateral, regional, or multilateral) offers the greatest promise over the time frame contemplated. The ability to motivate and sustain a constituency in favor of procurement reform is an important consideration and is likely to vary across reform options, time spans, and jurisdictions. To date, there is insufficient evidence to confidently recommend one reform vehicle over another.

For analysts, much remains to be done in analyzing compliance with, and the effect of, government procurement provisions in PTAs. It is unsatisfactory that the evidential base, whether in terms of legal compliance or of economic effects, that is needed to guide policy making is so thin. The hard and, some might say, tedious work of tracking what has happened after governments have taken on obligations on procurement in PTAs is still to be done. For example, in many PTAs the emphasis has been on trying to eliminate the more transparent forms of discrimination (such as price preferences), and this may have had the unintended consequence of driving discrimination into nontransparent forms.

Annex. PTAs with Government Procurement Provisions

The following PTAs containing government procurement provisions had been notified to the WTO as of December 2009.

Australia–Chile
 Canada–Costa Rica
 Canada–European Free Trade Association (EFTA)
 Canada–Peru
 Caribbean Community (CARICOM) (services)
 Central European Free Trade Agreement (CEFTA)
 Chile–China
 Chile–Colombia

Chile–Costa Rica
 Chile–El Salvador
 Dominican Republic–Central America–United States Free Trade Agreement (CAFTA–DR)
 EFTA (services)
 EFTA–Chile
 EFTA–Croatia
 EFTA–Egypt, Arab Rep.
 EFTA–Jordan
 EFTA–Korea, Rep.
 EFTA–Lebanon
 EFTA–Macedonia, FYR
 EFTA–Mexico
 EFTA–Morocco
 EFTA–Singapore
 EFTA–South African Customs Union (SACU)
 EFTA–Tunisia
 European Union (EU)–Albania
 EU–Algeria
 EU–Cameroon
 EU–Caribbean Forum of African, Caribbean, and Pacific (ACP) States (CARIFORUM) economic partnership agreement (EPA)
 EU–Chile
 EU–Egypt, Arab Rep.
 EU–Israel
 EU–Jordan
 EU–Mexico
 EU–Montenegro
 EU–Morocco
 EU–South Africa
 Iceland–Faroe Islands
 Israel–Mexico
 Japan–Brunei Darussalam
 Japan–Chile
 Japan–Indonesia
 Japan–Mexico
 Japan–Philippines
 Japan–Singapore
 Japan–Switzerland
 Japan–Thailand
 Japan–Vietnam
 Jordan–Singapore
 Jordan–United States
 Korea, Rep.–Chile
 Korea, Rep.–Singapore
 Mexico–Chile
 Mexico–Costa Rica
 Mexico–El Salvador
 Mexico–Guatemala
 Mexico–Honduras (goods)

Mexico–Honduras (services)
 Mexico–Nicaragua
 Pacific Island Countries Trade Agreement (PICTA)
 Panama–Costa Rica
 Panama–El Salvador
 Singapore–Australia
 Singapore–New Zealand
 Singapore–Panama
 Singapore–Peru
 Thailand–Australia
 Thailand–New Zealand
 Trans-Pacific Strategic Economic Partnership
 Turkey–Albania
 Turkey–Bosnia and Herzegovina
 Turkey–Croatia
 Turkey–Egypt, Arab Rep.
 Turkey–Georgia
 Turkey–Macedonia, FYR
 Turkey–Morocco
 Turkey–Palestinian Authority
 Turkey–Syrian Arab Republic
 Turkey–Tunisia
 Ukraine–Macedonia, FYR
 Ukraine–Moldova
 United States–Australia
 United States–Bahrain
 United States–Chile
 United States–Morocco
 United States–Oman
 United States–Peru
 United States–Singapore
Source: WTO data.

Notes

1. A feature of the literature on government procurement is the paucity of comparable cross-country estimates of the total amounts spent on goods and services. OECD (2001) is the most recent study to have assembled information for many industrial and developing countries, and it used 1998 United Nations data. The study shows that in 1998 the level of government spending on goods and services worldwide was, on average, 14.5 percent of gross domestic product (GDP); in industrial countries it was 17.1 percent.

2. Although the functions listed in this paragraph may be less intensively executed in developing countries, the experiences of certain industrial countries would suggest that it is unwise to assume that resource constraints are confined to poorer countries.

3. This argument is developed at greater length and with specific reference to the imprecise notion “policy space” in Dawar and Evenett (2008).

4. Strictly speaking there is a wrinkle in the value-for-money principle. To the extent that a government buyer has market (monopsony) power, the pursuit of this objective may result in prices at which market outcomes are inefficient—that is, the prices do not equal the marginal costs of production or the societal costs of producing the last unit of the

good or service in question. Given the size of many government purchasers relative to total demand in the market for a given good or service, this logical possibility has received remarkably little consideration.

5. Prevalent forms of discrimination against foreign firms in national procurement regimes include price preferences (which raise foreign bids by a certain percentage before they are compared with the bids of domestic firms), outright bans on foreign bidders, local content-related restrictions, and standards adopted in the procurement process that raise the costs of foreign firms.

6. Observant readers will have noted that any such procurement ban does not remedy the ultimate cause of the small size of the private sector.

7. There is some evidence in the corruption literature that improvements in the transparency of government procurement processes result in a shift of government spending toward more homogeneous goods and away from goods that are so heterogeneous that bids cannot be easily compared (which increases the potential for graft to affect the allocation of state contracts). For a summary of such evidence, see Evenett and Hoekman (2005). Bourgeois, Dawar, and Evenett (2007) summarize the little empirical evidence, mostly from the European Union, on the impact of procurement reforms and PTA procurement provisions. The principal findings are summarized in this chapter.

8. United Nations Commission on International Trade Law, "1994—UNCITRAL Model Law on Procurement of Goods, Construction and Services, with Guide to Enactment," http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/1994Model.html.

9. The type of discrimination referred to in the general principles is sometimes referred to as conditional MFN, in that each party offers MFN treatment to every other party to the accord. Nonsignatories are not offered MFN.

10. This clause is also seen in the EU agreements with Mexico and Jordan. The Trade, Development, and Cooperation Agreement (TDCA) between the EU and South Africa directs the Cooperation Council established under the agreement to review progress made in opening fair, equitable, and transparent procurement markets.

11. The parastatals referred to are government-controlled enterprises; they include the U.S. Tennessee Valley Authority (TVA), Canada's St. Lawrence Seaway Authority, and Mexico's national oil company *Petroleos Mexicanos* (PEMEX) and national electric company, the *Comisión Federal de Electricidad* (CFE).

12. The WTO GPA obligations apply to the goods and services listed in Annexes 4 and 5 of the agreement, again typically following a negotiated positive-list approach.

13. The thresholds are, for central government entities, 130,000 SDRs for procurement of goods and services and 5 million SDRs for procurement of construction services; for subcentral government entities, 200,000 SDRs for goods and services (except for the United States and Canada, which apply a 355,000 SDR threshold) and 5 million SDRs for construction services (except for Japan and the Republic of Korea, which apply a 15 million SDR threshold); for government-owned enterprises, 400,000 SDRs for goods and services (except for the United States, which sets a US\$250,000 threshold for federally owned utilities) and 5 million SDRs for construction services (except for Japan and Korea, which apply a threshold of 15 million SDRs).

14. By contrast, the exceptions to Article XXIII of the WTO GPA are more streamlined in that they cover security interests and social and philanthropic protection within one article.

15. A variety of terminology, depending on the country or organization, exists to describe the mechanisms for resolving a complaint by a would-be contractor on the conduct of the procurement process prior to the decision on selection: domestic review mechanisms; protests by disappointed bidders; complaints; or, simply, appeals. The WTO GPA refers to "bid challenges," and the UNCITRAL Model Law, to "bid review."

16. This paucity of information should not be surprising, given that, unlike the tariff provisions of PTAs, the behind-the-border provisions of such accords are a much more recent policy innovation.

17. Government procurement policies may be used to favor outright a certain group in society or, indeed, specific individuals. Leaving aside whether such favoritism is legal, it has long been suspected that resistance to reform of public purchasing practices in some jurisdictions has been influenced by the desire to preserve such practices. It is unclear why there would be less resistance to reform induced by a trade agreement than to unilateral reform.

18. Formally, the case of price preferences is different from that of tariffs in that the PTA leads to a loss of government revenues (the lost tariff revenues on the favored trade).

19. The replacement of other forms of discrimination by a transparent price-based instrument of discrimination is, of course, not new, as attempts at "tariffication" of nontariff measures can attest. The same logic applies in the procurement case.

20. Indeed, it is frequently contended by European Commission officials that many government procurement contracts in the EU can be contested by parties from all its trading partners.

21. One feature of these provisions is that a "weak" negotiating partner can benefit from a subsequent "tougher" negotiator's ability to extract more market access concessions from trading partners with which both the weak and stronger parties ultimately sign a PTA. These tactical considerations may add to the attraction of third-party MFN clauses for weaker negotiating parties, which may number among them many developing countries.

22. For example, according to Article 67, on further negotiations, of the EFTA–Mexico PTA, "In the case that the EFTA States or Mexico offer, after the entry into force of this Agreement, a GPA or NAFTA Party, respectively, additional advantages with regard to the access to their respective procurement markets beyond what has been agreed under this Chapter, they shall agree to enter into negotiations with the other Party with a view to extending these advantages to the other Party on a reciprocal basis." Article 18, on review of commitments, of the South Asian Free Trade Area (SAFTA), states, "If, after this Agreement enters into force, a Party enters into any agreement on government procurement with a non-Party, it shall give positive consideration to a request by the other Party for incorporation herein of treatment no less favourable than under the aforesaid agreement. Any such incorporation should maintain the overall balance of commitments undertaken by each Party under this Agreement." Article 160, on further negotiations, of the EU–Chile agreement specifies, "If either Party should offer in the future a third party additional advantages with regard to access to their respective procurement markets beyond what has been agreed under this Title, it shall agree to enter into negotiations with the other Party with a view to extending these advantages to it on a reciprocal basis by means of a decision of the Association Committee." Article 9, on further negotiations, of the U.S.–Chile PTA states, "On request of either Party, the Parties shall enter into negotiations with a view to extending coverage under this Chapter on a reciprocal basis, if a Party provides, through an international agreement entered into after entry into force of this Agreement, access to its procurement market for suppliers of a non-Party beyond what it provides under this Agreement to suppliers of the other Party."

23. There are studies that seek to forecast the increase in trade if government procurement policies were liberalized. These forecasts, however, are not the same as an estimate of the impact of the implementation of an actual PTA with government procurement provisions.

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