

Can Developing Countries Benefit from Negotiations on Transparency in Government Procurement in the Doha Round?

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What is at stake?

It is important to appreciate how large the world's government procurement markets are. Although precise estimates are hard to come by, a recent analysis by the Organisation for Economic Co-operation and Development (OECD) indicates that total *central* government expenditures of its members, excluding military spending and the compensation of state employees, was just under \$2 trillion in 1998.¹ The comparable figure for 106 non-OECD members, which account for 90% of the developing world's national incomes, was just under \$0.3 trillion. The latter is still a sizeable sum as it equals six times the total annual multilateral and bilateral aid currently received by developing economies. Moreover, prior studies have estimated that local and provincial governments tend to spend approximately half this amount on goods and services, bringing the size of the world's procurement market to well over \$3 trillion.

A large fraction of this spending is on services, with the fraction higher in industrial nations than in the developing countries. Another difference is that the low-income developing nations tend to have a sizeable proportion (10-20% is not uncommon) of their non-defence government budgets funded by aid, loans, or grants. To the extent that such aid is tied to purchases from firms in a donor country, then this diminishes

¹ See the presentation by Mr. Denis Audet of the OECD on "Quantifying the Size of Government Procurement" to a WTO Symposium on Transparency in Government Procurement, October 9-10 2002, in Geneva; downloaded from http://www.wto.org/english/tratop_e/gproc_e/gptran_symp_oct02_pdf_files/gptran_symp_oct02_sessio_n2_audet_e.pdf. See also a description of the OECD's findings in this area at <http://www.oecd.org/EN/document/0,,EN-document-0-nodirectorate-no-4-22456-0,00.html>.

the size of the *contestable* national procurement market, and arguably also comes at some cost to the recipient nation.

Estimates of the margin of preference—the price wedge that would generate the observed reluctance of governments to purchase from abroad—suggest that there is considerable discrimination against foreign suppliers in national procurement markets. Estimates of this margin by Francois, Palmeter, and Nelson (1997) range from 13% to 50% for leading OECD nations across a wide range of government purchases. If these price wedges were found in developing countries too, it would imply that the introduction of greater competition in national procurement markets could substantially reduce the pressure on hard-pressed governments to provide much needed public services and the like. Yet domestic procurement reform is very difficult to pull off and the next section discusses why.

Why reform of procurement practices is vital for developing countries but is so difficult to pull off?

Competition for government contracts can come from foreign as well as domestic firms, and research has amply demonstrated that certain state measures can reduce competitive pressures from both sources (see Arrowsmith and Trybus, 2003, and Evenett and Hoekman, 2002). Opaque tendering procedures and poor governance tend to discourage potential bids from both domestic and foreign firms; often leaving governments dependent on bids from a small group of “insider” firms. Contract prices tend to be higher, quality lower, and delays and cost over-runs common. Outright bans on procuring from foreign sources—or more subtle forms of preferences for national firms—reduce competition from abroad. Needlessly stringent pre-qualification requirements shut out bidders too; all to the detriment of the taxpayer who ends up paying more for less.

Despite its apparent benefits, domestic procurement reform is often notoriously difficult to accomplish. Hunja (2003) has identified the following impediments to unilateral reform:

1. “Deeply Vested Interests and Lack of Political Will” (page 17).
2. “Paucity of Technical Knowledge and Capacity” (page 18).
3. “Complexity of Substantive Issues Involved” (page 18) including the types of legal instruments involved, different means for organizing procurement functions, and enforcement-related matters.

Reviewing the experience of developing countries in this regard, Hunja (2003) argues:

“Evidence from countries where reform efforts have stalled for a long time indicates that it is very difficult to achieve wholesale, systemic changes to the legal framework in the absence of consistent political commitment and support from within the highest levels of government. Only support at such levels can overcome the progress and substantive obstacles to reform” (page 21)

He goes on to argue that:

“Because efforts to bring about fundamental changes to a flawed system may attract direct opposition if implemented by a self-standing program, one way to increase the possibility of success is to implement such reforms within the context of an existing package of reforms aimed at increasing the efficiency of the public sector...Many countries are in the process of improving their system of governance (of which management of public resources is a key aspect) and in implementing anti-corruption measures. Procurement reform fits well into any such programs and is bound to attract less direct opposition if it is part of a large reform effort” (page 22).

An alternative means for improving procurement practices is in the context of an international trade agreement and the following issues arise (i) whether this alternative can substitute for or complement domestic reform initiatives, and (ii) the circumstances under which this alternative is likely to yield benefits to developing countries. As a first step in addressing these issues, I will briefly describe and assess existing plurilateral disciplines on government procurement.

The Uruguay Round Agreement on Government Procurement (GPA)

The WTO Government Procurement Agreement (GPA) entered into force on January 1, 1996. It is one of two so-called plurilateral agreements that bind only signatories (Hoekman and Kostecki, 2001). At the time of writing, the GPA had only 26 members (Austria, Belgium, Canada, Denmark, the European Communities, Finland, France, Germany, Greece, Hong Kong (China), Ireland, Israel, Italy, Japan, Korea, Liechtenstein, Luxembourg, Netherlands, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States). Although China, Chinese Taipei, Iceland, the Kyrgyz Republic, Latvia, and Panama are negotiating accession, in some cases as part of general WTO accession, the current membership of the GPA is essentially limited to high-income countries.

The GPA establishes a framework of rights and obligations regarding the national procurement laws, regulations, and procedures of parties. Government are required to apply the principle of national treatment to the products, services, and suppliers of other parties to the GPA and to abide by the MFN rule (not to discriminate among goods, services, and suppliers of other parties.) The agreement emphasizes transparency of laws, regulations, procedures, and practices regarding government procurement. Five annexes to the GPA specify for each member which government authorities (central government, sub-central governments, and other state bodies such as utilities) are covered, and which purchases of goods and services are subject to multilateral disciplines. Only those transactions which exceed certain threshold levels are affected. Although a common threshold of SDR 130,000 was established for central government entities, thresholds for purchases of construction services and procurement by non-central government entities are often higher (see Hoekman and Kostecki, 2001).

All goods purchases are subject to GPA disciplines unless a nation secured exemptions during the agreement’s negotiation (or during subsequent accession to the agreement). In contrast, only those services listed in the Annexes are covered by the GPA. Thus, as in the GATS a ‘positive list’ approach to coverage was taken. Indeed,

there is a very close correspondence between GATS specific commitments and the coverage of the GPA. Although non-discrimination (MFN and national treatment) lies at the core of the GPA (effectively banning price preferences), many members have conditioned their commitments on market access to that offered by other members of the GPA (Hoekman and Mavroidis, 1997). This insistence on reciprocal access to procurement markets reduces the benefits of enhanced competition to supply domestic procurement contracts.

In addition to non-discrimination, the GPA has two other important features: measures to improve transparency in the procurement process and enforcement provisions. The agreement contains numerous provisions on the procurement process, including on the use of selected and invited tendering, the nature of technical specifications used in tenders, and the criteria to award contracts. For example, Article VI of the GPA enjoins nations from creating “unnecessary” obstacles to trade in setting specifications and calls for the use, “where appropriate,” of performance, rather than design standards.

Contracts must be awarded to the supplier that is deemed capable of undertaking the contract and satisfies one of the following two requirements: (i) the supplier made the lowest bid or (ii) the supplier best meets the evaluation criteria laid out in the original tender. Essentially, this latter requirement prohibits a procuring entity from refusing to award a contract to a supplier on grounds that were not specified in the tender. The effectiveness of this requirement depends critically on how broad are the evaluation criteria in the tender.

The transparency-related provisions of the GPA emphasise publication of tenders and notification of regulations to the WTO. *Ex post* transparency norms are relatively weak, however. The GPA allows a government to refuse to award a contract on “public interest” grounds, which are not defined. Once a contract award has been made the procuring entity does not have to provide an explanation to those bidders who did not win the contract. The latter is only required when a member government intervenes on behalf of a bidding firm under the GPA’s enforcement procedures.

The enforcement provisions of the GPA are particularly noteworthy. Recognizing that aggrieved bidders typically want rapid and effective redress, the GPA mandates that members establish impartial domestic arbitration procedures capable of making swift decisions. Complainants are allowed to invoke the provisions of this WTO agreement in making their case in a domestic arbitration procedure. In addition to these domestic procedures, members are allowed to bring cases to the WTO dispute settlement body.

Strengths and weaknesses of the GPA

Even though this assessment will be quite critical of selected aspects of the GPA, it should not be forgotten that this plurilateral agreement has expanded considerably the disciplines on public procurement procedures. We can expect, with a reasonably high degree of confidence, that membership of this agreement translates into lower procurement costs, allowing members to spread stretched government budgets across a wider range of activities. (Admittedly, how much lower has yet to be established with confidence.) Nevertheless, the agreement falls short of its potential for two

reasons. First, discrimination has only been tackled partially. Second, the benefits of membership of this agreement are highly contingent on the extent of bribery and corruption in an economy. Each concern is discussed in turn.

The provisions in the GPA allowing for conditional non-discrimination need to be rethought. Removing conditionality would expand the number of foreign suppliers that are treated similarly to domestic suppliers, encouraging competition, and lowering procurement costs.

The more important concern about the GPA's disciplines on discrimination is that they *only* ban price preferences. The GPA's provisions on discriminatory measures against foreign firms in regard to their costs, or to their ability to bid for state contracts, are much weaker. This is a concern because price preferences tend to be the least (economically) costly form of procurement discrimination (Deltas and Evenett 1997). Moreover, the current state of affairs is likely to encourage policymakers to substitute transparent price preferences for murkier forms of discrimination; so reducing the potential market access and welfare benefits of the GPA. (Of course, the GPA is not the only international trade agreement where possibilities for substitutability between trade policy instruments exists.)

An alternative would be to tighten up on the cost-based and entry-based discrimination, and channel any protectionist tendencies towards observable price preferences, whose levels can then subsequently be negotiated down over time. In addition, one could modify the pre-selection procedures to allow firms who have not pre-qualified to bid, but to do so with a fixed price preference applied against them. Apart from this price preference, such firms' bids would be treated identically to those firms who pre-qualified. The advantage of this provision is that it caps any distortions created by the pre-qualification process.

With respect to bribery and corruption, recent research has shown that this narrows the circumstances under which procurement reform yields benefits (Evenett and Hoekman 2002). To the extent that bribes and pay-offs to government officials result in a higher price being paid by taxpayers for a good, then this reduces the quantity demanded by government. This increases the likelihood that this government demand can in principle be met solely by domestic producers, which means that the subsequent imposition of a procurement ban (or other form of discrimination) against foreign bidders merely redistributes government sales from foreign firms to domestic firms, without the latter's output rising. Domestic consumers' demand shifts from domestic firms to foreign firms at exactly the same rate as government demand is shifting in the opposite direction. Under these circumstances, the net effect of procurement discrimination on imports (market access) is zero. By the same logic, the removal of such discrimination will not increase imports (market access) either. What does this imply about the effectiveness of the GPA? Well the presence of bribery and corruption ensures that there are more markets where the elimination of price preferences will have no effect on both imports and national welfare.

The arguments above suggest that the current GPA is not delivering much in terms of improvements in market access or welfare for developing countries (and for industrial countries, for that matter.) The question now before policymakers is whether a reformed GPA which has additional focus on transparency is likely to better meet the

needs of developing countries? First, I describe current discussions in the WTO on transparency in government procurement. Then, I summarise the main findings of recent research of the effect of improving transparency on market access, the currency of the realm in the multilateral trading system.

Transparency in Government Procurement: the road from Singapore to Cancun

A Working Group on Transparency in Government Procurement Practices was established after the 1996 WTO Ministerial Meeting in Singapore.² The mandate of this Working Group was contained in that meeting's Ministerial Declaration and called for:

“the working group to conduct a study on transparency in government procurement practices, taking into account national policies, and, based on this study, to develop elements for inclusion in an appropriate agreement.”³

Notice that the focus of the Working Group's discussions was not to be expanding market access, rather to improve transparency. This particular emphasis on the latter reflected a marked reluctance of certain WTO members—including many developing countries—to take further steps to open up their procurement markets to *foreign competition*.

The Working Group produced four annual reports between 1997 and 2001. In addition, in November 1999 the Chairman of the Working Group issued a “List Of The Issues Raised and Points Made,” which summarised the major topics discussed in that Group up until that point in time. (These topics are still the principal matters discussed in the Working Group.) This “List” identified the following twelve topics:

1. Definition and scope of government procurement
2. Procurement methods
3. Publication of information on national legislation and procedures
4. Information on procurement opportunities, tendering and qualification procedures
5. Time-periods
6. Transparency of decisions on qualification
7. Transparency of decisions on contract awards
8. Domestic review procedures
9. Other matters related to transparency
10. Information to be provided to other governments (notification)
11. WTO dispute settlement procedures
12. Technical cooperation and special and differential treatment for developing countries

At the 2001 WTO Ministerial Conference in Doha, Qatar, a concerted effort was made by a number of WTO Members, including the EU and the US, to obtain

² For an analysis of the origins of this Working Group, and its relationship to the Uruguay Round GPA, and the likely consequences of strengthening transparency provisions in the GPA, see Arrowsmith (1997).

³ See “Singapore Ministerial Declaration—Adopted on 13 December 1996,” World Trade Organisation, document WT/MIN/96/DEC.

agreement to launch negotiations on transparency in government procurement. This was opposed by a number of developing countries, which tended to be of the view that the WTO should continue studying and discussing this subject with a view to identifying good practices and determining what the benefits of multilateral disciplines might be. In the event, it was agreed in principle to launch negotiations on this subject at the 2003 Ministerial Conference, on the basis of modalities that must be agreed by explicit consensus. This leaves open the possibility that negotiations could be blocked through a veto, or, alternatively, that WTO members could agree that the outcome of negotiations need not apply to all members.

I now turn to a brief summary of the likely effects of adopting transparency-related provisions in a revised GPA.

Would improving transparency in government procurement have effects on welfare and market access in developing countries?

In principle, there are two types of effects from improving transparency in procurement practices:

1. domestic governance-related benefits that flow from less graft and greater predictability for potential bidders for government contracts, and
2. market access-related effects which can include changes in the access to domestic procurement markets by foreign firms and changes in the access to foreign government procurement markets by domestic firms.

As noted earlier, the likelihood of governance-related benefits depends on whether the domestic implementation of potential transparency provisions in a GPA is backed by the country's senior political leadership and is part of a broader set of governance reforms. Indeed, to the extent that the adoption of a reformed GPA galvanises domestic political support for broad-based governance reform—and not just reform of the government procurement system—then this potential multilateral initiative could have considerable payoffs. Unfortunately, the argument can go just as easily the other way; specifically, without the support of senior political leaders implementing new multilateral disciplines on transparency is unlikely to have much of a governance-related impact in developing countries.

In part, because of the inconclusive nature of the above arguments, recent research has begun to consider other potential effects of adopting international disciplines on transparency in government procurement. Given the long-standing focus on market access in the multilateral trading system, it is perhaps not surprising that recent research has focused on the effects on improvements in transparency in government procurement on imports and exports of goods potentially sold to governments. One could object to this line of analysis on the grounds that—as stated in the last section—governments explicitly shifted away from market access-improving measures in the procurement arena to transparency-improving measures, and on the basis of the public statements of many WTO members, this is indeed the case. Nevertheless, as a matter of logic, it is possible that transparency-improving measures can have (perhaps indirect) consequences for market access—the scale of which is worth exploring. This was precisely the line of reasoning considered in a recently-published paper by Evenett and Hoekman (2003).

In their analysis of improving transparency in procurement process, Evenett and Hoekman (2002) considered the following (realistic) case: that the procurement processes for differentiated products tend to allow for more discretion by procurement officials—potentially presenting opportunities for corrupt officials to collect bribes.

The first step in Evenett and Hoekman’s argument was to appeal to the following finding, which is supported by a growing body of empirical literature on the nature and effects of corruption in procurement settings, namely,

“that corrupt officials deliberately expand expenditures on goods and projects—such as aircraft and construction—which are highly differentiated and for which there are few, if any, comparable reference prices in world markets. Recent econometric analysis supports the contention that governments which are perceived to be more corrupt spend more on military procurement and on arms imports. Put simply, officials with an interest in rent collection are likely to employ non-transparent procurement regimes to expand government spending on those items where the opportunities for self-enrichment are greatest (Evenett and Hoekman 2003, page 276).”

This finding suggests that the composition of government spending shifts towards goods and services that have relatively less transparent procurement processes. In addition, Evenett and Hoekman point to a separate body of evidence which suggests that small and medium enterprises are less willing to bid for government contracts if they have to bribe government officials. In economic terms, to the extent that non-transparent procurement procedures reflect the desire to collect bribes by corrupt government officials, then the willingness of firms to supply the government’s needs here is smaller than it would otherwise be.

These two stylised facts were used to analyse the effects of introducing a WTO agreement that eliminated non-transparency in procurement procedures. Evenett and Hoekman argue that such an agreement would shift government demand away from more differentiated towards more homogenous goods, and would increase the number of *both domestic and foreign* firms willing to bid for government contracts. In most of the cases analysed in their paper, Evenett and Hoekman found that the demand for imported differentiated products would fall—suggesting that eliminating transparency need not raise foreign market access.

What are the policy implications of this analysis? Developing country exporters of differentiated products should not expect to gain much in terms of improved overseas market access from the adoption of transparency provisions in a reformed GPA. However, exporters of more homogenous goods may see some beneficial impact. On the import side, developing countries are likely if anything to see a reduction in purchases of differentiated products and perhaps an increase in foreign sourcing of homogenous goods by the government. Overall, there does not appear to be a clear market access benefit to developing countries of new transparency-related provisions in a reformed GPA.

One can summarise the principal arguments advanced in this section as follows: the governance-related effects of improving transparency in government procurement are

highly contingent on continued political support and the trade-related impacts are unclear and are likely to be, on net, small. A caveat, however, is in order. Unlike other areas of trade reform—such as cutting tariffs—the amount of available empirical and conceptual research to guide policymaking is very small in case of government procurement reform. It is quite possible that new research in this area could have markedly different implications for policymaking. Even so, current research does point to highly contingent and limited benefits of adopting new international rules on transparency in government procurement.

Policy recommendations or Where to go from here?

The key issue is whether policymakers should give up on attempting to improve government procurement through international trade agreements. Given the difficulties in pulling off unilateral domestic procurement reform in developing countries, it is still worth exploring whether an international trade agreement can galvanise political constituencies behind domestic reform in return for some other benefits—such as improved market access benefits abroad. As we have seen above, putting transparency provisions *at the core* of such an international agreement is unlikely to stimulate much support from domestic exporters. The developmental impact of implementing such provisions will, then, be entirely contingent on the continued support of the national political leadership—which cannot be taken for granted.

Can we do better? Arguably yes, by *augmenting* or *substituting* the current proposals for improving transparency with a comprehensive focus on market access reforms in government procurement. As the earlier discussion on the current GPA notes, there is plenty of room to tighten up measures that prevent foreign firms from bidding for government contracts and measures that raise their cost of doing so. Indeed, it was suggested that WTO members may want to strengthen the disciplines on these measures, perhaps at the “political price” of allowing countries to re-establish price preferences. The economic benefits of such an initiative would flow from moving away from the use of opaque and more costly policy instruments towards relatively less costly and more transparent ones. (Of course, the greater the price preferences that replace these more opaque measures, the smaller the economic benefits from such an international agreement.) Such a reform would also have the advantage of opening up markets abroad, so benefiting domestic exporters but also providing them with an incentive to ensure that domestic procurement reform stays on track and is not undermined by local vested interests.

In sum, current proposals for multilateral disciplines on transparency are likely to yield, at best, modest gains for developing countries; and may not justify launching full negotiations on this subject at the WTO. The interests of developing countries might be better served by augmenting proposed disciplines on transparency with measures to improve access to procurement markets.

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