

# Summary

The overall objective of this analysis is to assess the potential trade effects of rules on procurement policies on Commonwealth African, Caribbean and Pacific (ACP) group members. The main aim is to facilitate the understanding of Commonwealth ACP members about the effects on their economies of negotiating rules on government procurement policies in regional and international trade agreements and to determine strategies that will best advance their development interests in these forums.

As a result of the confusion which exists concerning terminology and the scope of the issues being negotiated in the context of procurement-related trade arrangements, the report begins by seeking to provide a clear and concise explanation of some of the issues and terms used in the context of public procurement regulation. In particular, it considers the terms ‘transparency’ and ‘market access’ (also referred to as ‘liberalisation’). Significant confusion arises because a transparent domestic procurement system is seen as a precondition of membership of a regional or international organisation, which then imposes market access conditions, and discussions relating to membership of such an organisation address the questions of transparency and market access more or less simultaneously.

The key point of departure of this report is to explain by illustration and by reference to the relevant literature that the benefits of a sound domestic procurement system (in other words, a ‘transparent’ procurement system) arise independently of any market access conditions imposed by or granted to bidders from third countries. There are two separate issues: first, the creation of a sound domestic system; and second, where it is desired, the opening up on a reciprocal basis of the domestic procurement market, relying on non-discrimination principles such as ‘national treatment’. It is this latter step, of accepting market access conditions, that may well have an effect on the make-up of the domestic procurement market, on the identity of the bidders and on existing trade flows. These may be termed the ‘trade effects’ of the international procurement regulation, since it *may* be the market access conditions of the agreement which produce these effects.

In addition to considering transparency and market access, the report also seeks to clarify other topics, notably international competition and regulation. It is important to recognise that international trade or competition is not the result of any international agreement on market access. Whenever a country needs to purchase something it does not produce or manufacture, it is obliged to seek providers from outside its borders and to import its requirements. The global economy is, for good or bad, a reality. The question is how it can be managed from the perspective of a domestic market. We consider attempts to control or manage the effects of international trade and to gain the maximum benefit from the advantages it has to offer by the many

governments that have opted to create regional or international regulatory systems whose aims are to garner these advantages by creating a level playing field between the participants. The rules which they adopt reflect the belief that free international (or regional) trade will provide increased social benefits to the members of the different groupings. To achieve those benefits, national objectives need, to whatever extent is possible, to be limited, so that they do not create or maintain obstacles to the achievement of freer trade.

The report explains that under such systems national objectives are not prohibited as such and members will usually be allowed to maintain national policies which are designed to protect matters which fall pre-eminently within the ambit of the exercise of national sovereignty, such as national security, public health and national heritage. However, it is recognised that governments are content to subscribe to such systems not only because they seek to develop their own domestic markets through competitive forces, but also because they see advantages for their own suppliers in having access to the markets of third countries. They see access as a means of maximising their comparative advantage. The report points out that it is not only developing countries that benefit from exceptions to the World Trade Organization's (WTO) procurement system. Industrialised countries which otherwise openly welcome free access to their procurement markets have also negotiated a significant list of areas of procurement that are either excluded from the general provisions, because they fear difficulties as a result of their comparative disadvantage, or which are subject to policy considerations which they are reluctant to give up.

Given the prevalence of national protective measures, the report also considers the issue of domestic price preferences as the most frequent type of protective measure, even though they are often used without any well-articulated economic justification. The report considers the economic literature describing the use of such preferences and concludes that there is some doubt as to the efficacy of domestic preferences and that they have no effect on trade, i.e. they do not reduce imports or increase domestic prices, output or employment. To operate optimally, price preferences would have to apply on an industry by industry (or product by product) basis, according to the relative cost advantages between domestic and foreign suppliers; if they are carried out properly, they could even militate in favour of a price preference for foreign goods where they have a comparative cost disadvantage. The absence of trade effects rests on the premise that government demand does not account for all purchases and that there is a sufficiently large private market for the same (substitutable) goods. In these circumstances, discriminatory price preferences which shift the demand of the government buyer towards domestic products will generate an equal and opposite shift in private consumer demand towards imports, because the private sector can buy the identical (or substitute) product at the same price on world markets. This does not always hold true, but even then the economic literature finds negligible effects. In conclusion, the beneficial effects of price preferences remain dubious, while the costs for the country applying them and for international trade remain certain.

Following this preliminary clarification, the report turns to the issue of transparency. Where any country is seeking membership of a regional or international economic organisation in respect of procurement, its membership will depend on the quality and level of transparency of that system. A country seeking membership of a trade arrangement will need to be aware of the adequacy of its own procurement system. In this regard, we consider five core transparency mechanisms in turn, expanding on the general introduction to explain what is involved at the level of the legal framework. The mechanisms are: publication of the legal framework; publication of procurement opportunities; procedural transparency; transparency of contract awards; and transparent dispute settlement. We then consider the benefits of improved transparency in government procurement (TGP) and the costs of improving it. We also incorporate some of the findings of the country assessments in respect of the sample countries (Dominica, Nigeria, Samoa and Tanzania) to provide an idea of the level of transparency they might achieve. Since information has been collected from secondary sources which are often out of date, and it has been impossible to verify the findings on site or with the authorities of the countries in question, this is not a definitive assessment. The reports do, however, enable us to draw some general conclusions.

The report starts from the premise that the benefits of transparency or, perhaps more precisely, the degree of transparency, are intimately linked with the benefits of an effective and efficient procurement system. It is not surprising that the most frequently stated benefit of TGP is increased competition. This reflects the common belief held by those operating within a market economy that competition is what produces the optimal result in terms of efficiency. We also recognise that one of the by-products of transparency in the domestic context is to highlight the existence of inefficient firms. If companies (bidders) do not produce efficiently and cannot match the prices of their competitors (i.e. they offer higher prices than the prevailing market prices), then they will in theory lose out. If their situation is irredeemable, they may well be forced to close. This issue clearly comes to a head in the context of discussions aimed at trade liberalisation. Where markets are opened to international competition, there is a fear that such competition will be so efficient that it will force competing domestic industries to close. The choice facing the government is the same: to protect inefficient domestic industry and pay too much or to accept the competition and risk seeing some domestic companies fail.

Economic theory is used to explain other benefits of transparency. This rests on the principal/agent theory, which explains that the relationship between the government (principal) and the procurement officer (agent) gives rise to a problem of information. In terms of procurement, the agent is closer to the procurement process and will consequently have more information about the market and the suppliers. This creates an informational asymmetry between principal and agent which may, where their interests diverge, allow for exploitation by the agent. This poses an immediate threat to the procurement process in terms of market purchases. We explain how procurement regulation is used to redress the information imbalance by providing a means of

controlling the procurement agent so that the principal can verify where necessary the procurement actions and decisions of the agent and make sure that he is indeed acting in the real interests of the government and, by extension, the country. It is thus a tool used by the government to guarantee knowledge of the facts for the purposes of verification and administrative control. In this way, we explain how in economic terms TGP can be used to rein in the corrupt, incompetent or careless procurement agent and ensure that they conduct the procurement function in the interests of the government.

We also consider the benefits and costs of transparency. The difficulty in obtaining hard empirical evidence of cost savings is due mainly to problems in obtaining accurate and reliable data. We rely on studies carried out in the European Union (EU) by the World Bank and the Organisation for Economic Co-operation and Development (OECD). These suggest that overall savings are in the order of 30 per cent, which would represent significant budgetary savings in most developing countries. In terms of costs, any country negotiating access to an international procurement agreement will also need to be aware of the costs of making the necessary improvements. They may benefit from financial assistance in making those improvements. The costs will not be negligible, but the costs of implementing the specific transparency tools identified in the report may be quantified. The second cost issue concerns the broader costs, including the 'cost' of not applying TGP. Since the transparency tools are linked to the underlying system, the failure of the system is reflected in the lack of transparency and the costs of such a system will be the failure of the government to make any of the expected budgetary savings.

Turning to the question of market access, it is not possible in this report to consider the approach of all potential trade agreements. However, the emerging trend is for trade agreements to follow the model of the Agreement on Government Procurement (GPA), at least in structure. As a result, we have taken the GPA as an example of the way in which international procurement agreements have been negotiated. The history of the GPA serves this purpose well, since it highlights very clearly the difficulties and pitfalls of the negotiating process and offers some lessons for aspiring members. This allows us to investigate the potential trade effects and possible policy decisions.

In particular, we consider the central debate over the definition of government (federal, central or sub-central), which related to the concern of negotiators to ensure that any agreement will bring trade advantages to all the signatories and that these advantages will be of equivalent value. The key was the achievement of reciprocal trade advantages. Linked to this was the question of financial thresholds. The lower the threshold, the more contracts and entities would be covered. The higher the threshold, the fewer contracts and entities would be involved, and this could well affect the net value of the 'contribution' of the different parties. Developing countries involved in the negotiations favoured lower thresholds, since this would enhance their prospects of gaining access to the procurement markets of developed countries by enabling them to compete for the lower value and less sophisticated contracts.

The history of the negotiations highlights the tensions between the various parties and also explains the specific characteristics of the current GPA. It demonstrates very clearly the limitations placed on the GPA that result from the contracting parties' desire not to create a model international procurement system, but to extract maximum benefit for their nationals by guaranteeing access to the procurement markets of other contracting parties and granting access to their own markets only on a reciprocal basis. Whilst ostensibly based on the non-discrimination principles of most favoured nation (MFN) and national treatment, these principles are in fact qualified by the negotiated market access provisions of the GPA.

There is also a lack of hard data relating to the actual trade effects created by membership of any international agreements which apply market access conditions in respect of procurement. There would appear to be consensus (and some economic evidence) that a sound domestic procurement system leads to welfare benefits, mainly based on increased competition. To the extent that transparency provisions also encourage international competition (irrespective of any mandatory market access conditions), they will also have trade effects in the sense that they will facilitate the cross-border provision of goods and services. From the perspective of a party's negotiating position, therefore, it may well be that the primary benefits from entering into a procurement-related trade agreement will result from the inevitable precondition of attaining acceptable transparency of the national procurement system. The effort required to bring the country's procurement system 'up to speed' is more likely to bear fruit than the following market access negotiations.

The existing studies which seek to identify the benefits of introducing TGP or improving current procurement systems are invariably linked to the savings to be made based on the size of the procurement market involved, but there is little to suggest that the state procurement markets of much of the developing world are large enough to attract the attention of international bidders. Moreover, it is not just the size of the market that matters, but also its susceptibility to foreign competition. This involves a consideration of entity coverage in terms of the identity of the purchasing entities subject to the transparency provisions (whether central or regional/local and the position of sub-federal states) and the question of threshold values. In addition to the size distribution of contracts (smaller contracts tend not to be attractive to foreign firms), it will also concern the share of government services that are 'contracted out' to the private sector. The share of expenditure financed through development assistance funds that are tied to sourcing goods and services from the donor country is also a contributing factor.

The potential trade effects will depend very largely on the individual situation of the negotiating party. Clearer predictions would require an in-depth study of country circumstances, although research and the existing literature provide some basis from which to make this analysis. In the case of market access, the key for the parties (in the GPA at least) was to ensure that any agreement would bring trade advantages to all the parties and that these advantages would be of equivalent value. The potential

trade effects must, therefore, be assessed from two perspectives: that of domestic industry and that of foreign competition. In the first place, this requires an assessment of the strengths of the domestic industry, since reciprocal market access will, in theory, present domestic industry with increased opportunities for export business. This in turn depends on what is produced by the domestic market and whether the country (or its industry) has a comparative advantage.

The issues to be considered by negotiating parties are clear, but the policy options that are available will depend on the situation of the country in question. There are two main concerns: transparency and market access. The primary benefits of entering into trade arrangements which liberalise procurement markets are felt in the domestic market. This presupposes, however, that there is a domestic procurement system which is able to accommodate effective competition. In any event, such a system is a prerequisite for membership of such organisations.

The first option, or rather opportunity, given to negotiating parties is therefore to bring their domestic systems up to an acceptable level. This may well be of benefit to the wider membership of the organisation where market access conditions are accepted, but the greatest results will be for the domestic market. This provides an opportunity for the negotiating parties to secure technical and financial assistance for the development of their national systems with a view to generating the welfare effects resulting from a sound and transparent procurement system. Even if the negotiating country ultimately decides not to enter into market access commitments, the benefits of more transparent government procurement will already have been achieved.

Once the transparency position is resolved, the remaining options relate to the specificities of the country in question. This will be a question of assessing the nature of the domestic market, its strengths and weaknesses. These are a function of the size of the market, the identity of the procuring entities, the applicable thresholds, the size distribution of contracts, the value of procurement financed by donors and subject to tied aid, the current trade flows, and the strengths and weaknesses of the country's sectoral markets. The results of an investigation into these issues will dictate the policy options available.

It has not been possible to consider all types of trade agreements, but for the reasons stated above the GPA has been used as the primary example. In respect of developing countries, the GPA currently contains some specific provisions which will assist them in negotiating preferential access to the agreement. For example, the GPA contains provisions which seek to establish special and differential treatment for developing countries. This will include tolerance of certain preferences, at least as a temporary measure. Other concessions will be made for negotiating parties from developing countries, as well as the exemptions that may be negotiated to coverage similar to those already accepted for the benefit of current members. This process will also be reflected in other trade groups. Once they have made the required market analysis, these are the provisions that should be exploited by the negotiating parties if they are to benefit from membership.