



Note

Liberalising Government Procurement in the Multilateral Trading System

Perspectives for the East African Community

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Summary

At the WTO, government procurement is increasingly attracting attention in the negotiations. The main goal of liberalising procurement is to promote competition among local and international suppliers of various goods and services in order to obtain the best value for money. This note explores the implications of commitments to liberalising this important area of government business, including the likely advantages and disadvantages based on existing literature on the subject.

Introduction

Government procurement is an area that is increasingly attracting attention in negotiations and discussions, be it in the multilateral trading system, or Free Trade Agreements including regional integration processes. This is due to its perceived and real effects on trade and national development efforts, more so in the case of developing and least developed countries.

The main objective of liberalising (open and non-discriminatory) government procurement (GP) is to promote competition among potential local and international suppliers of various goods and services in order to obtain the best value for money. However, GP is often driven by secondary objectives that are sometimes inconsistent with the principle of obtaining best value for money. For instance, the government being the largest procurer in most economies may discriminate against foreign companies in procurement to achieve its industrialization development, and job creation objectives by promoting national industries. The government may also favour foreign firms for reasons such as promoting foreign direct investment (FDI). Achieving these secondary objectives usually involves using trade distorting techniques such as discriminatory tendering requirements and selective tendering among others.

At the WTO, negotiations on GP led to the establishment of a plurilateral Agreement on Government Procurement (GPA) in 1979 under the General Agreement on Tariffs and Trade (GATT). The agreement was revised in 1996 and 2012, with the revised version entering into force in 2014. The GPA provides a framework of rights and obligations in which parties agree that suppliers of goods and services in signatory countries will not be treated less favourably than domestic suppliers in procurement covered by the agreement. In particular, the GPA treaty's provisions apply to all public goods purchased and to only those services which are specifically annexed to the agreement. Exceptions to the GPA rules are possible, for example on the grounds of national interests or in case of procurement of military products. Additionally, the laws, regulations and procedures concerning GP in signatory countries are required to be transparent and fair. The GPA is a voluntary instrument and to date 47 members of the WTO have acceded.

Most developing countries, including the East Africa Community (EAC) members, are yet to accede to the GPA. However, there are consultations to consider whether GP should be negotiated into a binding agreement in the WTO.

Given the rising interest in government procurement in the negotiation ambit of the WTO, this note seeks to assess the implications of commitments to liberalising

this important area of government business, including the likely advantages and disadvantages based on existing literature on the subject.

Should Developing Countries Liberalise Procurement?

Government procurement accounts for more than 10% of GDP in the great majority of countries. For a long time, states, including developing countries, have used public procurement as a way to support national interests – a practice that can be perceived as a non-tariff barrier to free trade, and therefore the rationale for multilateral disciplines in this regard.

A Case for Liberalising Government Procurement

The GPA is conceived as a tool to boost economic development at the global level through further liberalisation of world trade and increased international competition. The main ground upon which positive outcomes are claimed is the theory of comparative advantage (Wade, 2003). More specifically, it is argued that government procurement policies discriminating between domestic and foreign suppliers lead to inefficiencies that prevent optimal utilisation of trade liberalisation.

The potential beneficial effects can be summarized as follows (Kattel and Lember, 2010):

- Access to other countries' markets;
- More competition that leads to increased international competitiveness;
- Job creation;
- Budgetary savings and increased transparency in tendering procedures.

For developing countries, however, the main benefits are likely to be *domestic*. In fact, the gains coming from having access to other countries' markets would not be significant (Falvey, La Chimia et al., 2007). In terms of job creation, the main arguments support the idea that, while in the short-run increased competition may lead to job losses, in the long-run the net effect on employment would be positive. This is premised on the fact that for instance there is likely to be a positive effect on the job market in the long-run, since domestic firms

will export *more* – thus increasing their size and hiring more – because of gains in access to other countries’ markets (Ssenoga, 2006). Furthermore, as highlighted by a recent WTO study, another possible factor in increasing employment could be through sub-contracting to local firms/workers by a foreign supplier after winning a contract. (Dadush, Osakwe, 2015).

Therefore, it seems fair to say that, from a developing world perspective, opening up to international procurement will lower the cost for the provision of public goods and services – allowing for budgetary savings – and increase the perceived transparency of tendering procedures. The potential positive effect in terms of market access is not likely to be very significant. Additionally, the consequences for the total employment will not arguably be easy to predict in advance.

Likely Disadvantages to Liberalisation

Despite the above benefits likely to result from liberalising GP markets, very few developing countries – Hong Kong [China], South Korea, Singapore and ten Eastern European countries – have acceded to the GPA so far (Falvey, La Chimia, 2007).

Literature (Kattel and Lember et al, 2010) has divided the main reasons for which developing countries avoid joining the GPA agreement into four categories:

- Political;
- Technical;
- Secondary policy-related;
- Economic (developmental).

Political reasons refer to those policies discriminating foreign suppliers through nationalistic arguments. Political concerns of this kind are usually a very popular means to gain consensus. Furthermore, liberalising public procurement mechanisms poses technical challenges, especially for developing countries. In fact, it could be particularly costly for those states to implement some of the GPA’s requirements (setting up a proper institutional environment, providing accurate statistics, fulfilling transparency). Additionally, the GPA’s regime could pose an obstacle to countries’ autonomy in putting in place certain measures (such as social and industrial policies). For this reason, many developing countries have shown resistance in sacrificing their policy space even in light of the benefits of opening up the procurement markets.¹ Finally, economic

¹ Diplomacy Dialogue – Panel Session on the GPA – Monday, 11 June, 2012

counterarguments also need to be taken into consideration. Kettel and Lember (2010) argue that economic theory has studied the outcomes generated by public procurement under the assumption of perfectly competitive markets. The typical results were against any discrimination in government procurement procedures.

Conversely, this conceptualization does not properly capture the significant role played by governments of the North during the last century (Wade, 2003). Indeed, many firms of today's developed countries have benefited from the high internal demand – guaranteed by their domestic government's demand of goods and services. As has been argued (Trionfetti, 2000), home-biased procurement could be a more desirable solution than full liberalisation for those developing countries with a small internal market. The main risk is that a full liberalisation could cause the production of some goods to re-locate in other countries with larger demand and market size (Trionfetti, 2000).² In this context, discriminating between foreign and domestic suppliers could be seen as a way to avoid putting domestic market under unfair foreign competition (Wade, 2003).

² This is especially the case for the production of goods in market with increasing returns and monopolistic competition

Moving Forward: Public Procurement as a Development Strategy

It has been pointed out (Rodrik, 2001), that discussions at the WTO tend to consider global integration as a “substitute for development strategy”. From the perspective of developing countries, Singh (2002) underlines that any form of competition policy should be evaluated primarily on the ground of its capability to sustain economic development. This is why the optimum level of competition might not always correspond to the *maximum* for those countries.

Edler and Georghiou (2007) further argue that government procurement can be used as a tool to promote industrial policies.

Public Procurement for Innovations

The role of the public sector can be to support domestic suppliers' investments and aim at spurring innovation. With regard to this, literature (Uyarra, Flanagan et al., 2009) refers to public procurement as a way to facilitate clusters formation and innovation systems, thereby positively

influencing urban, regional and national competitiveness. This would also lead to economic development for a region or country. More practically, public procurement for innovation (PPfI) could allow governments – by acting on the demand-side – to absorb higher risks and entry costs arising from the creation of new markets of goods or services. Also, by being the first demander of innovative productions, and increasing domestic suppliers’ capacities, the public sector could reinforce the link between innovation and production (Lember, Kalvet, Katter, 2008). Furthermore, past studies (Edler and Georghiou, 2007) have shown that government’s use of public procurement to promote innovation and ultimately economic growth is more desirable than other policies (supply-side R&D subsidies, for instance). There is, however, one major *caveat* that policy makers and negotiators of developing countries should consider when evaluating the use of public procurement as a tool for economic development. This strategy requires *high* policy capacity in order to be really effective (Katter and Lember, 2010). With regard to this, Ssenoga (2006) underlines the importance for developing countries to enhance their competitive focus on quality of goods and

services. In this sense, the author maintains that it is crucial to increase access to finance, R&D, managerial, technical skills and access to global supply chains.

EAC: Reforms and Concerns over the GPA

In the past years, the EAC has increased its economic integration. With regard to public procurement law, the goal seems to be harmonization of those regulations.

Indeed, the EAC has already adopted a protocol establishing a common market, with obligations including non-discrimination among suppliers, products and services from other partner states so as to increase the benefits of free trade and competition (EAC Trade Report, 2014). EAC Member countries have also put in place reforms at the national level concerning increased transparency over public procurement procedures.³ As an example, Uganda has adopted amendments to its procurement law, including in the definitions of “national provider” to include all companies owned by EAC citizens (Arrow Smith, Quinot, 2013). Additionally, the current EAC guidelines on procurement recognize the possibility to carry out open regional competition *in lieu* of an international open competition – where

³ See <http://www.eac.int/about/opportunities/procurement>

“regional” is to be limited to firms from the partner states.

Although the GPA represents an effort towards good governance and transparency, it is not yet immediately clear that the potential costs of implementing it would be lower than the benefits. On the contrary, a concern is that the costs of compliance with increased transparency might outweigh the positive outcomes of liberalisation. In line with this, Fenster (2003) argues that most of the gains could be achieved through unilateral reforms. Moreover, including transitional measures and exceptions – as the current revised agreement does for developing countries⁴ - is not necessarily enough as an incentive for developing and least developed countries. This is because it is not always easy to predict in advance which sectors should be included or excluded from the agreement.

Conclusion

The literature reviewed in this note shows that it is not uncontested for developing countries and the EAC to adopt the GPA. Indeed, it is fair to say that the benefits deriving from enhanced competition and better value-for money services could be outweighed by important costs of

compliance. For these countries, the highest levels of competition might not always lead to the most desirable outcomes, at least in the short-run. In particular, government procurement can still be seen as a key tool to promote economic development through innovation. Never the less, developing countries’ policies are shaped by global market forces; hence it is necessary to achieve adequate policy capacity at the government level to sustain economic growth through competitive strategies.

Reforming government procurement is arguably a critical policy to foster development. That this enhanced competitiveness, however, should derive from adopting the plurilateral GPA or negotiating multilaterally binding disciplines in this regard is debatable.

The path the EAC has taken seems to be in the direction of higher economic regionalism. In this perspective, harmonization of the regulation on public procurement conducted on a regional level might better serve the needs of these countries. Beside this, increased regionalism – should this prove to be fruitful – would not prevent any future potential accession to the multilateral liberalisation of procurement.

⁴ As, for example, negotiable exclusions for coverage to limit exposure of sensitive sectors

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