

The WTO and Government Procurement

Edited by
Simon J. Evenett and Bernard Hoekman



Critical Perspectives on the
Global Trading System and the WTO

D913
W958

The WTO and Government Procurement

Edited by

Simon J. Evenett

*Professor of International Trade and Economic Development
University of St Gallen, Switzerland*

and

Bernard Hoekman

Research Manager

International Trade, World Bank, USA

and Visiting Professor

Groupe d'Économie Mondiale, Institut d'Études Politiques, Paris, France



CRITICAL PERSPECTIVES ON THE GLOBAL TRADING SYSTEM AND THE WTO



E200603712

An Elgar Reference Collection

Cheltenham, UK • Northampton, MA, USA

© Simon J. Evenett and Bernard Hoekman 2006. For copyright of individual articles, please refer to the Acknowledgements.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior permission of the publisher.

Published by
Edward Elgar Publishing Limited
Glensanda House
Montpellier Parade
Cheltenham
Glos GL50 1UA
UK

Edward Elgar Publishing, Inc.
136 West Street
Suite 202
Northampton
Massachusetts 01060
USA

A catalogue record for this book is available from the British Library.

ISBN-13: 978 1 84542 600 2
ISBN-10: 1 84542 600 2

Printed and bound in Great Britain by MPG Books Ltd, Bodmin Cornwall.

The WTO and Government Procurement

Critical Perspectives on the Global Trading System and the WTO

Series Editors: Kym Anderson

*Professor of Economics and Executive Director, Centre for
International Economic Studies
University of Adelaide, Australia
and Lead Economist, Development Research Group
World Bank, USA*

Bernard Hoekman

*Research Manager, International Trade
World Bank, USA*

*and Visiting Professor, Groupe d'Économie Mondiale
Institut d'Études Politiques, Paris, France*

1. The WTO, Intellectual Property Rights and the Knowledge Economy
Keith E. Maskus
2. The WTO and Agriculture (Volumes I and II)
Kym Anderson and Tim Josling
3. The WTO and International Trade Law/Dispute Settlement
Petros C. Mavroidis and Alan O. Sykes
4. The WTO and Technical Barriers to Trade
Spencer Henson and John S. Wilson
5. The WTO, Trade and the Environment
Gary Sampson and John Whalley
6. The International Trading System, Globalization and History (Volumes I and II)
Kevin H. O'Rourke
7. The WTO and Anti-Dumping (Volumes I and II)
Douglas R. Nelson and Hylke Vandenbussche
8. The WTO and Government Procurement
Simon J. Evenett and Bernard Hoekman

Future titles will include:

The WTO's Core Rules and Disciplines

Kym Anderson and Bernard Hoekman

The WTO and Reciprocal Preferential Trading Arrangements

Caroline Freund

The WTO, Safeguards and Temporary Protection from Imports

Chad P. Bown

Wherever possible, the articles in these volumes have been reproduced as originally published using facsimile reproduction, inclusive of footnotes and pagination to facilitate ease of reference.

For a list of all Edward Elgar published titles visit our site on the World Wide Web at
www.e-elgar.com

Acknowledgements

The editors and publishers wish to thank the authors and the following publishers who have kindly given permission for the use of copyright material.

American Economic Association for article: Kaz Miyagiwa (1991), 'Oligopoly and Discriminatory Government Procurement Policy', *American Economic Review*, **81** (5), December, 1320–28.

Blackwell Publishing Ltd for articles: Albert Breton and Pierre Salmon (1996), 'Are Discriminatory Procurement Policies Motivated by Protectionism?', *Kyklos*, **49** (1), 47–68; Aaditya Mattoo (1996), 'The Government Procurement Agreement: Implications of Economic Theory', *World Economy*, **19** (6), November, 695–720; Harvey Gordon, Shane Rimmer and Sue Arrowsmith (1998), 'The Economic Impact of the European Union Regime on Public Procurement: Lessons for the WTO', *World Economy*, **21** (2), March, 159–87; Federico Trionfetti (2000), 'Discriminatory Public Procurement and International Trade', *World Economy*, **23** (1), 57–76.

Cambridge University Press and the World Bank for excerpt: Inbom Choi (2003), 'The Long and Winding Road to the Government Procurement Agreement: Korea's Accession Experience', in Will Martin and Mari Pangestu (eds), *Options for Global Trade Reform: A View from the Asia-Pacific*, Chapter 11, 249–69.

Copyright Clearance Center for excerpt: Vivek Srivastava (2003), 'India's Accession to the Government Procurement Agreement: Identifying Costs and Benefits', in Aaditya Mattoo and Robert M. Stern (eds), *India and the WTO*, Chapter 10, 235–67.

Elsevier for articles: R. Preston McAfee and John McMillan (1989), 'Government Procurement and International Trade', *Journal of International Economics*, **26**, 291–308; Simon J. Evenett and Bernard M. Hoekman (2005), 'Government Procurement: Market Access, Transparency, and Multilateral Trade Rules', *European Journal of Political Economy*, **21** (1), March, 163–83.

Kluwer Law International (www.kluwerlaw.com) for article: Sue Arrowsmith (2003), 'Transparency in Government Procurement: The Objectives of Regulation and the Boundaries of the World Trade Organization', *Journal of World Trade*, **37** (2), 283–303.

Oxford University Press for articles: Kenneth W. Abbott (2001), 'Rule-making in the WTO: Lessons from the Case of Bribery and Corruption', *Journal of International Economic Law*, **4** (2), June, 275–96; Sue Arrowsmith (2002), 'Reviewing the GPA: The Role and Development

of the Plurilateral Agreement after Doha', *Journal of International Economic Law*, 5 (4), 761–90.

Norman Paterson School of International Affairs, Carleton University, Canada for excerpt: Robert E. Baldwin and J. David Richardson (1972), 'Government Purchasing Policies, Other NTB's, and the International Monetary Crisis', in H.E. English and Keith A.J. Hay (eds), *Obstacles to Trade in the Pacific Area: Proceedings of the Fourth Pacific Trade and Development Conference*, 243–9, 251–63.

State Secretariat for Economic Affairs (SECO) for excerpt: Simon J. Evenett (2003), 'Is There a Case for New Multilateral Rules on Transparency in Government Procurement?', in State Secretariat of Economic Affairs and Simon J. Evenett (eds), *The Singapore Issues and the World Trading System: The Road to Cancun and Beyond*, Chapter III, 169–253.

Southern Economic Association for article: Thomas C. Lowinger (1976), 'Discrimination in Government Procurement of Foreign Goods in the U.S. and Western Europe', *Southern Economic Journal*, 42 (3), January, 451–60.

Sweet and Maxwell for articles: Annet Blank and Gabrielle Marceau (1996), 'The History of the Government Procurement Negotiations Since 1945', *Public Procurement Law Review*, 5, 77–147; Dimitri Mardas (2001), 'Indicators for Measuring the Potential Economic Impact of Opening Government Procurement and their Application to the Situation of Hungary', *Public Procurement Law Review*, 10 (6), 283–93.

University of Michigan Press for excerpts: George Deltas and Simon Evenett ([1997] 2000), 'Quantitative Estimates of the Effects of Preference Policies', in Bernard M. Hoekman and Petros C. Mavroidis (eds), *Law and Policy in Public Purchasing: The WTO Agreement on Government Procurement*, Chapter 4, 73–89; Bernard M. Hoekman ([1997] 2000), 'Operation of the Agreement on Government Procurement, 1983–1992', in Bernard M. Hoekman and Petros C. Mavroidis (eds), *Law and Policy in Public Purchasing: The WTO Agreement on Government Procurement*, Chapter 5, 93–104; Joseph Francois, Douglas Nelson and N. David Palmer ([1997] 2000), 'Public Procurement in the United States: A Post-Uruguay Round Perspective', in Bernard M. Hoekman and Petros C. Mavroidis (eds), *Law and Policy in Public Purchasing: The WTO Agreement on Government Procurement*, Chapter 6, 105–24.

Every effort has been made to trace all the copyright holders but if any have been inadvertently overlooked the publishers will be pleased to make the necessary arrangement at the first opportunity.

In addition the publishers wish to thank the Library of Indiana University at Bloomington, USA for their assistance in obtaining these articles.

Introduction

Simon J. Evenett¹ and Bernard M. Hoekman²

1. Introduction

This volume concerns the nature, extent, and consequences of current and potential future trade-related disciplines on public procurement policies and associated institutions. As a starting point, it is important to recall the national significance of public purchasing. State agencies worldwide procure the goods and services necessary for the execution of government functions, such as education, defence, utilities, infrastructure, public health, and so forth. The associated public procurement markets often represent significant shares of national income. Not surprisingly, then, many governments concerned with optimising the use of scarce financial resources have developed procedures and mechanisms to encourage public entities to procure goods and services at least cost and in a fair and transparent manner. Government procurement policy also influences one of the principal relationships between the public and private sector, both domestic and foreign. Not only is efficiency in public purchasing of fundamental importance in ensuring that the greatest value for money is obtained by public entities, but procurement practices will also figure prominently in the way potential investors and civil society at large view a country's governance and investment climate. As well as having a direct bearing on development-sensitive state programmes, the implementation of government procurement policies reveals much about the governance-related priorities and challenges facing a society. Devising and effectively implementing the right procurement policies and rules at the national and international level is, thus, of considerable importance.

The priority attached by many countries to attaining efficiency in public purchasing is very high. South Africa, for example, has included a section on procurement principles in its 1994 Constitution. This requires that procurement be undertaken on the basis of a fair, public, and competitive process by independent and impartial tender boards that are to maintain records of decisions and account for them to interested parties.³ A common element of many procurement systems is to mimic the working of the market by requiring that public entities seek competitive bids from potential suppliers of goods and services. Over time, an increasing number of governments have also pursued more far-reaching efforts to subject state-directed activities to competitive forces through the privatisation of state-owned enterprises, the encouragement of entry into sectors traditionally reserved for public entities (e.g., utilities), and the contracting-out of activities to the private sector. While many developing countries have adopted procurement legislation and regulations that seek to ensure that public entities source goods and services through an open and competitive process, to what extent actual practice is consistent with the adopted rules and procedures is often difficult to determine. This is, in part, because the incentive to contest violations of procurement regulations may be small, or worse existing rules may discourage the lodging of legitimate complaints.

Insofar as procurement policies favour domestic firms and products they can impede international commerce. Such impediments can be prohibitive; for example, when there is an outright ban on purchases from foreign providers. Alternatively, they may be similar in some respects to an import tariff by the granting of price preferences to domestic bidders for state contracts. Effective market access could also be constrained if procurement rules prohibit sourcing from foreign-owned firms, even if they have established a presence in the market through foreign direct investment (FDI). Indeed, it is this market access dimension to discriminatory procurement practices that has often provided the rationale for including disciplines on government procurement policy in international trade agreements, including multilateral accords.

In practice, however, as far as the rules of the world trading system are concerned, public procurement is rather unique in that the general disciplines of the General Agreement on Tariffs and Trade (GATT) do not extend to it. Two important policy measures that affect market access and competition on markets were explicitly exempted from the GATT national treatment obligation in 1947 (Art. III.8 GATT): subsidies and government procurement. The treatment of the former has come to be regulated in a separate multilateral agreement, the WTO Agreement on Subsidies and Countervailing Measures. However, the latter continues to be exempted from general, multilateral WTO disciplines. Currently, procurement practices are regulated by a so-called plurilateral agreement that binds only those 37 WTO members that have accepted its provisions.⁴

As discussed at length in Blank and Marceau (1996, Chapter 1, this volume), the genesis of this agreement dates back to the mid-1970s, when a number of industrialised countries launched negotiations on this topic in the OECD, and subsequently transferred a proposal to negotiate a framework agreement to Geneva as part of the Tokyo Round. The resulting Government Procurement Agreement (GPA) extended the basic principles of the GATT – non-discrimination, national treatment, and transparency – to the tendering procedures of specified government entities.⁵ The GPA has been renegotiated a number of times since the end of the Tokyo Round (1979), greatly increasing its substantive coverage.⁶ However, as noted above, membership of the current GPA remains limited. Although many developing country governments have implemented measures to improve the efficiency (that is, to lower the cost and to improve the quality) of public procurement, they have refrained from signing the GPA. This is surprising, insofar as the presumption is that the GPA should be a useful mechanism for ensuring that procurement regimes maximise value for money. After efforts to expand membership of the GPA during the 1980s failed, demanders (such as the EU and US) shifted tack and proposed that efforts centre on a more limited set of multilateral rules to ensure transparency in the procurement process of all WTO members. Agreement to discuss the possible modalities of a negotiation on transparency in government procurement was obtained in 1996 at the Singapore Ministerial meeting. The proposals advanced from 1996 are described and analysed in the chapters by Arrowsmith (2003, Chapter 4, this volume) and Evenett (2003, Chapter 5, this volume). It transpired that agreement to launch negotiations on even this limited agenda proved impossible at the WTO Ministerial Meeting in Cancun in September 2003. Later, the July 2004 Framework Agreement among WTO members effectively ended the prospect of negotiating multilateral rules on transparency in government procurement for the remainder of the Doha Round. The implication is that at the time of writing public procurement policies remains one of the holes in the WTO's trade policy edifice.

The major substantive disciplines imposed by the GPA are its non-discrimination, competitive tendering, and transparency provisions, complemented by the domestic and multilateral enforcement mechanisms. We shall not review the provisions of the GPA here, as that is the subject of two of the chapters in this volume, namely Blank and Marceau (1996), and Arrowsmith (2002, Chapter 3, this volume). Instead, in this Introduction we review the objectives and instruments of national procurement policy, the types of discrimination possible in procurement policy and their effects, the rationales for subjecting procurement policies to international disciplines, and possible explanations as to why domestic reforms in this policy area often stall. We hope that this background will help put the chapters in this volume in context, as the central questions in the area of international rule-making in public procurement do not just concern what policy initiatives enhance national well-being, but also what are the benefits, costs, risks, and opportunities created by different types of international cooperation. The latter includes not just the binding type of rules found in the GPA, but also the 'soft law' alternatives of the type discussed by Abbott (2001) in Chapter 2, this volume and Arrowsmith (2002). We have collected some of the most innovative and foundational research on these questions in this single volume, and hope that scholars, government officials, trade diplomats, and the like, will have a more informed basis upon which to assess the pros and cons of further international initiatives in the area of public purchasing.⁷

2. Factors Contributing to or Impeding National Procurement Reforms

The growth of spending by central and local governments was one of the most profound economic changes of the twentieth century (Tanzi and Schuknecht, 2000). Although a large portion of that growth was devoted to higher transfer payments, governments of all types spent considerable sums on goods and services produced by the private sector. In addition, state-owned industries procured substantial quantities of inputs from private firms. As a consequence, through its purchases the state has had considerable influence over the allocation of resources in market-based economies.

Throughout much of the post-World War II era most nations' local and central governments were supplied by their own firms. Discrimination against foreign suppliers was rife. Two justifications were offered for this discrimination. First, the prevailing Keynesian macroeconomic orthodoxy emphasised that the increase in national income caused by a rise in government expenditures was greater the smaller was the share of each dollar spent on goods produced abroad (imports). Governments could reduce this share – or what economists call the marginal propensity to import – by refusing to buy goods from abroad. And so procurement discrimination became associated with the noble goal of macroeconomic management. The second rationale for pervasive discrimination against foreign suppliers is far less glorious – nationalism or outright protectionism.⁸ Often it was claimed that 'our money' should be spent on 'our goods' to keep 'jobs at home'. Consequently, government procurement was excluded from the original GATT. In fact, it was not until the completion of the Tokyo Round of multilateral trade negotiations that an agreement on disciplines for government procurement practices was introduced into the world trading system.

During the Uruguay Round of multilateral trade negotiations, the GPA was strengthened. Three factors underlie this shift towards greater acceptance of international rules on national

procurement practices. First, since the mid-1970s government budgets have come under increased pressure, especially in industrial nations. Spending on the welfare state, health, education, and pensions has increased considerably. Governments are then faced with the following unpleasant choices: raising taxes or cutting non-welfare state-related spending. Since the former has become increasingly unpopular in many developing and industrial countries, greater emphasis has been placed on the latter. And one means to reduce non-welfare spending has been to stimulate competition between those firms that bid for government contracts – and allowing foreign suppliers to bid for these contracts helps accomplish this goal. Greater pressure on public budgets, therefore, has been conducive to procurement reform.

The second factor has been the widespread privatisation of state-owned enterprises. Without governments standing behind them, these enterprises know that poor management decisions will not be ‘bailed out’ by the state – leading to what economists refer to as a ‘hardening of the budget constraint’. In addition, the owners of the newly privatised firms know that their profits will not be entirely appropriated by the state. These two changes provide the privatised firm with an incentive to lower costs, including the expenditures on goods and services bought from other firms. Since most state-owned firms procured (like their governments) from domestic firms, privatisation is likely to increase the opportunities for foreign suppliers that sell high-quality competitively-priced goods and services. As privatisation continues in the future, this will reinforce the opportunities for cross-border procurement.

The third factor conducive to procurement reform is often referred to as ‘export politics’. Domestic firms eye profitable opportunities in supplying foreign governments and press their own government to negotiate ‘access’ to those overseas procurement markets. In industries where there are strong economies of scale – that is, average costs which fall as production levels increase – firms have an incentive to increase sales at home or abroad. Although one government could begin bilateral negotiations with another government to open the latter’s procurement market, the most prevalent path to reform has been for nations in the same region to simultaneously increase the access to their procurement markets to firms from the same region. Reciprocity is at the core of such agreements to liberalise together, as contracts lost by domestic firms to foreign suppliers are compensated for by an increase in the contracts won in neighbouring countries. The export gains can be balanced against the loss in sales to domestic firms – or so the theory underlying this approach to trade negotiation goes. Such a regional approach to procurement reform has advanced furthest in the European Union, and this experience had considerable influence in shaping the GPA negotiated during the Uruguay Round.

Another important aspect of procurement reform relates to the so-called transparency of the numerous steps associated with the implementation of a procurement law. Transparency, which refers to the publication, notification, and dissemination of pertinent information about a procurement regime to actual and potential bidders and to the public at large, is quite distinct from overt measures to discriminate against or in favour of one class of potential suppliers for state contracts. The absence of transparency is said to reduce the number of firms willing to bid for state contracts, so reducing competition and increasing costs (OECD 2003).⁹

3. Targets and Instruments of National Procurement Policies

Tinbergen, the Nobel-prize winning economist, introduced the distinction between a government's targets and instruments. The former are the objectives that the government wishes to achieve, and the latter are the means employed in attempts to meet those objectives. This distinction in no way validates, or endorses, the targets chosen by the government; nor does it imply that any given instrument has the desired effect. In the case of government procurement policies, these tend to have multiple targets and numerous instruments. This reality complicates an analysis of procurement policies, and in part accounts for the multi-faced nature of international disciplines on the design and implementation of such policies.

3.1. Targets

Perhaps the most common objective of procurement policies is to obtain 'value for money' for the government in its purchases. This straightforward objective itself has many facets; it could mean the purchase of goods, that meet certain quality levels, at minimum cost. Alternatively, it could mean choosing the good with the highest quality among a set of similarly priced goods. At a first cut this objective seems unobjectionable. However, this is to forget that the key metric used by economists to evaluate government policies is the effect of such policies on economic efficiency. Efficiency is attained when the price paid for a good (service) reflects the value to society of the resources used to produce the last unit of that good. One classic source of inefficiency occurs when a buyer with considerable market power artificially reduces the quantity purchased so as to induce suppliers to lower their prices. Therefore, it is important to bear in mind that attaining the lowest possible price, or 'value for money', in government purchasing need not generate efficient economic outcomes.

Governments also use procurement policies to favour certain groups, firms, regions, and industries. For example, such favouritism is widespread in the United States and India where the central government favours small firms who bid for contracts. More recently, South Africa has considered instituting a scheme which will favour black entrepreneurs and firms that employ stipulated numbers of black employees. This is part of a sweeping initiative to enhance the economic status of the majority black population after the fall of the apartheid regime. Finally, purchases of military equipment have long been subject to different rules, as nations have felt the need to maintain a broad range of military production facilities for national defence purposes. Because these objectives of procurement policy do not directly relate to maximising economic efficiency, economists refer to them as 'non-economic' objectives; a term that does not imply that these objectives are misguided or unattainable. Rather, this term is applied when governments have explicitly decided to adopt measures that may well lead to market outcomes that do not maximise economic efficiency.

Given the widespread adoption of non-economic objectives by governments, economists have researched extensively their consequences, especially in the area of international trade policy. The main finding of this research has been to show that the amount of economic efficiency sacrificed to meet a non-economic target varies considerably across instruments – and so it makes sense to determine which instrument attains the desired goal with the smallest reduction in economic efficiency. In so doing, economists have argued that it is better to tackle the direct source of the problem at hand rather than take measures that only indirectly bear on the matter.

For example, governments may want to promote the number and production levels of small firms by awarding these firms state contracts even though at least one large firm submitted a lower bid. An economic approach might point to a different course of action: first, the government should identify the impediments faced by small businesses and take measures that directly remedy them. If, for example, the critical impediment to the growth of small firms is access to financial credit, then policies should be directed towards bolstering the supply of credit to small firms – rather than using indirect means such as deliberately increasing the sales of small firms through government contracts.

The arguments above are not theoretical hair-splitting – they have direct relevance for the reform of government procurement policies. Governments may be more inclined to eliminate a procurement scheme that favours a certain industry if they know that other forms of state intervention can better attain this objective. Furthermore, if the chosen form of state intervention directly tackles the constraint of the favoured industry's or group's performance, then economic efficiency can be improved also.

3.2. Instruments

The manner in which governments procure goods and services can be complex and leaves plenty of room for favouritism towards groups of suppliers. The main focus here is on favouritism towards domestic suppliers, or alternatively put, discrimination against foreign suppliers. At this point it is worth noting that a supplier can be foreign, and therefore the potential subject of discrimination, in two respects: the supplier is located overseas or the supplier is located domestically but is partially or fully foreign-owned. The latter includes subsidiaries of multinational corporations whose headquarters are located abroad. Moreover, discrimination that is explicitly stated in national law or published regulations, it is said to be *de jure*. Discrimination that results from the implementation of those laws and regulations is often said to be *de facto*.

A description of the stages of a typical procurement process for goods is helpful in identifying where discriminatory instruments can affect outcomes. (It should be added that there are additional means by which discrimination against foreign services providers can occur, and these are discussed in subsection 3.3 below.) If a government decides not to effectively ban outright foreign bids for a contract then, in essence, the procurement of goods can be divided into three distinct stages: tendering, evaluation, and award notification and review procedures. At the tendering stage the government notifies a supplier or suppliers of its desire to procure certain types of goods. The government can specify the type of goods that it wishes to buy – including, in principle, the manner in which those goods are to be produced. There are three types of tendering procedures: open, selective, and limited. In open procedures an interested supplier, located at home or abroad, can submit a bid or, as it is often called, a tender. Under selective procedures only those pre-qualified firms may submit a tender. Pre-qualification is an additional step where a firm must demonstrate its potential to deliver goods of appropriate quality in a timely fashion. As this determination depends on the judgement of the procuring officials, some suppliers (including foreign firms) may be at a disadvantage if they do not have a track record in supplying the relevant goods. A limited tendering procedure tends to be the most restrictive as the procuring agency involved contacts individual suppliers and invites only these suppliers to submit tenders. This is not to say that limited tendering is always

inappropriate. (Indeed, ensuring quick delivery in a time of national emergency may require the use of limited tendering.) Rather, that limited tendering frustrates one of the principal objectives of procurement reform – namely, to stimulate competition among suppliers which is likely to result in lower prices paid by the government. Finally, if governments rely on existing suppliers when conducting limited tendering, then new foreign and domestic suppliers will almost certainly lose out on procurement opportunities.

The specification of the goods being procured also introduces the potential for discrimination. For example, a government might require that the goods be produced in firms that adhere to certain health and safety standards for workers. As these regulations differ across countries, foreign suppliers may find their costs have to rise to meet another nation's standards, reducing their ability to effectively compete in a tendering process. Even if a foreign firm already meets those standards, there may well be costly verification procedures which too reduce the effective competition from foreign bidders. Tendering procedures, therefore, can result in two forms of *de facto* discrimination against foreign suppliers – discrimination that directly or indirectly reduces the number of bidders and discrimination that increases the costs of foreign bidders. In what follows, these government measures are referred to as 'entry' and as 'cost' discrimination, respectively.

The evaluation of tenders is the next critical stage in the procurement process. As firms rarely bid to supply identical goods, the procuring official will have to assess not only the price of the tender but also a whole series of non-price factors – such as the quality of the good, the quality of after-sales service, the reliability of the supplier, and the like. Many of these factors are hard to quantify and some subjective judgements are inevitable. However, such judgement is to be distinguished from explicit discrimination against certain groups of suppliers. Governments may employ price preferences to increase the value of the bids of disfavoured suppliers. For example, a ten per cent price preference against foreign suppliers implies that their actual bids will be inflated by ten per cent before being compared to the bid prices submitted by domestic suppliers. This puts foreign firms at a disadvantage as raising a bid typically reduces the probability of winning a government contract.

There is one caveat to the presumption that a lower priced bid increases the chances of securing a state contract, and that is when a bid is too low to be commercially viable. At first this may seem implausible, however, it is important to remember that firms often supply a good well after the contract is awarded. For example, if a firm is building a bridge for a government and the firm runs out of money (because its bid was below the cost of producing the bridge), then the government is in something of a bind. Does the government begin the procurement process afresh, or is it cheaper to pay the existing contractor additional sums to complete the bridge? The latter involves the supplier being 'bailed out' by the government; and so the bridge costs more (possibly much more) than originally envisaged. Furthermore, the possibility that a supplier may be subsequently bailed out affects the prices that each firm bids in the first place. And, if domestic firms are more likely to be bailed out than foreign firms, this confers an advantage on domestic bidders for state contracts. Procuring officials often check, therefore, that tenders with exceptionally low bids have the capacity, and the incentive, to complete any contract that is awarded to them. These arguments have been developed at length in Mattoo (1996, Chapter 8, this volume.)

The role of intangible factors – that are part of the decision as to which firm to award a contract to – can undoubtedly cause controversy. Firms that do not win the contract may feel

that they were discriminated against, that the evaluation was conducted unfairly or incorrectly, or that irrelevant factors were taken into account. Consequently, many governments have established review procedures that enable firms to challenge the decisions of procuring officials. The specific details of these procedures determine, in large part, their effect of the tendering and award steps of the procurement process. If aggrieved parties can only recover the cost of preparing the bid and the cost of mounting a challenge, then a firm will be disinclined to object to a procurement decision, unless there is the expectation that similar tenders will be issued in the future and that the challenge will alter the subsequent behaviour of procuring officials. (Of course, the firm might also be concerned about retaliation by these officials in future tenders.) In contrast, if the challenge procedure offers the potential to win substantial damages, then this may well reduce inappropriate behaviour by procuring officials. This beneficial effect must be seen beside the costs of frivolous challenges and the increased bureaucratic measures that officials will take in order to reduce the likelihood of successful challenges by initially unsuccessful bidders. Finally, to the extent that foreign firms believe that they are unlikely to receive a fair and objective hearing from a domestic challenge procedure, then another form of discrimination is introduced into a nation's procurement system. This increases the likelihood that the entry-based, cost-based, and price-based discrimination identified earlier will occur, again reducing the benefits that accrue to governments from competition between potential suppliers.

3.3. Services

Up until now this discussion has focused on purchases of goods, with the implicit assumption that a foreign firm can supply a domestic government contract by exporting a good. This mode of supply is, in the parlance of trade experts, called the 'cross-border movement of goods'. When discussing the procurement of services three other modes of supply are of importance, each of which reflects the fact that many services can only be delivered when the supplier is physically proximate to the purchaser. The first of these three modes of supply is referred to as establishing 'commercial presence'. Here a foreign firm sets up a subsidiary, or forms a joint venture with a domestic firm, within the borders of the 'home' nation. Once established, this subsidiary or joint venture can attempt to bid for the home government's service contracts. The ability to establish presence, and therefore to bid for government contracts, is highly contingent on government policies towards FDI, joint ventures, and foreign mergers and acquisitions of domestic firms. Strict rules on foreign takeovers of domestic firms are likely to reduce this method of establishing presence and, therefore, will alter the nature and extent of tendering for government service contracts.

The two other modes of supply relate to the movement of people across national boundaries. Effectively supplying some services, such as accounting, auditing, consulting, and legal services, may require the temporary movement of personnel. Other services, such as recurring maintenance and perhaps nursing, may require longer-term or even permanent migration of workers, especially if there is insufficient expertise in the domestic labour force. In both cases the ability of a foreign firm to contest the domestic service market – irrespective of whether the buyer is a government or not – depends critically on the nation's policies towards work visas and migration.

This discussion implies that a government that wants to reap the full benefits of competition between potential service suppliers cannot confine itself to implementing a transparent and

non-discriminatory government procurement regime. As services can be supplied through four modes of supply (cross border-movement for tradable services – and the additional three modes described above), policies towards each mode of supply can affect the intensity of competition in the services market. It should be noted that foreign firms do have some choice over which mode of supply to use. For this reason, some have argued that a nation may not need to open all modes of supply in order to derive the benefits from foreign competition. While there may be some validity to this argument in certain situations, in general just because a foreign firm has access to at least one mode of supply does not imply that the permitted mode(s) are the lowest cost mode(s) of supply. Furthermore, as the costs of each mode of supply are likely to vary across industries and over time, there is little reason to suppose that opening any one mode of supply in general (such as permitting foreign direct investment) will maximise the benefits to governments of foreign competition for procurement contracts (Evenett and Hoekman 2000).

3.4. Corruption and Collusion

Given that firms (domestic and foreign) want to secure lucrative government contracts, and that some officials may be motivated by personal self-interest as well as by promoting the public interest, it should come as no surprise that corruption and collusion are a feature of government procurement. Firms may decide to reduce the competition for contracts by agreeing (or ‘rigging’) the prices that they submit to the procuring entity. Often, these conspiracies involve each firm taking its turn to win a government contract. For these conspiracies to be sustained typically there must be repeated tendering by the state over time, so holding out the prospect of future contracts for those engaged in the conspiracy. As a separate matter, a firm or firms could attempt to bribe or induce government officials to view their tenders more favourably, and such corruption has been extensively researched (see Bardhan 1997 and Rose-Ackerman 1999 for surveys).

Without attempting to present a full analysis of the sources and effects of corruption here, for present purposes it is important to recognise that procurement rules – whether international or domestic – should be designed with the possibility of corruption in mind. Given the considerable scope for discretion on the part of procuring officials, much can be done to force those officials to make their decisions in an open and transparent fashion. Likewise, so-called carrots and sticks can be offered to officials to induce them not to take bribes.

4. The Scale of National Procurement Markets and the Extent of Discrimination

Given the importance of the state sector as a determinant of national economic performance, it is perhaps surprising that there is little systematic cross-country and inter-temporal evidence on the size of national procurement markets. OECD (2001) uses National Accounts (SNA) data to compute the magnitude of government spending in the OECD member states and in 106 non-OECD economies. Specifically, measures of government spending were obtained by adding state expenditures on investment (gross fixed capital formation) to either expenditure on all current acquisitions (intermediate consumption) or expenditure on final consumption and subtracting the total outlays on the compensation of employees. Table 1 reports the estimates in OECD (2001) of this size of procurement markets in the OECD member states.

Table 1: Size of government procurement markets in OECD nations, 1998

OECD member	Total government expenditure less outlays on defence and compensation, as a percentage of GDP					
	SNA-based measure			SNA-based measure that takes into account intermediate consumption		
	(1) General government	(2) Central government	(3) = (2)/(1)	(4) General government	(5) Central government	(6) = (5)/(4)
Australia	7.64	0.86	0.11			
Austria	11.71	2.31	0.20	11.71	2.31	0.20
Belgium	4.84	1.95	0.40	3.87	2.03	0.52
Canada	10.40	0.62	0.06			
Czech Republic	15.74	2.71	0.17	11.21		
Denmark	10.04	2.75	0.27	10.04		
Finland	9.00	3.58	0.40			
France	7.63	1.81	0.24	7.63	1.81	0.24
Germany	6.72	0.81	0.12	6.62	0.81	0.12
Greece	6.73	3.76	0.56			
Hungary	16.78	7.03	0.42			
Iceland	11.76	3.62	0.31			
Ireland	9.93	2.59	0.26			
Italy	7.38	2.12	0.29	7.11	1.94	0.27
Japan	8.98	1.29	0.14			
Korea	7.20	1.94	0.27			
Netherlands	7.98	2.71	0.34	8.11	2.71	0.33
New Zealand	6.67	3.05	0.46	8.34	5.94	0.71
Norway	9.65	3.82	0.40			
Poland	9.72	5.57	0.57			
Portugal	6.22	3.80	0.61	6.18	3.49	0.56
Slovak Republic	14.09	8.21	0.58			
Spain	8.06	1.95	0.24	8.40	2.08	0.25
Sweden	13.01	4.67	0.36			
Switzerland	8.02	1.50	0.19	7.86	1.45	0.18
Turkey	6.84	4.96	0.73			
United Kingdom	9.97	5.88	0.59	9.77	6.09	0.62
United States	6.18	1.09	0.18			
OECD weighted average	7.57	1.75	0.23	8.22	2.79	0.34
EC weighted average	8.03	2.53	0.32			

Source: OECD (2001)

On average, in the OECD nations government procurement on items other than defence and compensation for state employees entails outlays equivalent to 7.57 per cent of national incomes. These calculations imply that in 1998 approximately US\$1.795 trillion of government expenditures were potentially contestable by firms located at home and abroad. Moreover,