GOVERNMENT PROCUREMENT IN FTAS: AN OUTLINE OF THE ISSUES

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Government procurement is one of the key negotiating issues in many bilateral Free Trade Agreements involving a developed and a developing country or developing countries. It is also an issue which has the most serious social, economic and developmental implications for developing countries.

In FTAs that the United States has signed or is negotiating with developing countries, there has been a strong demand by the US for a government procurement chapter involving market access to the government procurement business of the developing country concerned.

The FTA chapter typically involves: (1) Market access for each party to the government procurement market of the other party; (2) National treatment for the foreign firms and products; (3) A wide definition of government procurement, involving various levels of government (national, regional and municipal) and various types of government business. (4) The chapter also contains "threshold levels" representing monetary values; the agreement applies only if the contracts put out by the governments are valued at the threshold levels or above.

The US-Chile FTA provides an example of such a government procurement chapter. One of the objectives is to "strive to provide comprehensive coverage of procurement markets by eliminating market access barriers to the supply of goods and services, including construction services."

The scope and coverage applies to any measure relating to a procurement "by any contractual means, including purchase and rental or lease, with or without an option to buy, build-operate-transfer contracts, and public works concession contracts." Not included are non-contractual agreements or assistance provided by government, such as grants, loans and subsidies; purchases funded by international grants; hiring of government employees; and services for regulated financial institutions.

The agreement covers procurement carried out by entities listed in an annex. For Chile, these include 20 federal Ministries, many regional governments and 341 municipalities.

For the US, they include 79 federal departments and many offices of state governments.

The same annex, has also specified the same threshold levels for both countries. The threshold levels are $56,190 for procurement of goods and services and $6.48 million

for procurement of construction services for the central government level and threshold levels of $460,000 and $6.48 million respectively for the sub-central level.

The main general principles are National Treatment and Non-Discrimination. In any measure governing government procurement, each Party shall give to the goods and services of the other Party, and to the suppliers of the other Party, "treatment no less favourable than the most favourable treatment the Party accords to its own goods, services and suppliers."

Also, neither Party may treat a locally established supplier less favourably than another local supplier on the basis of degree of foreign affiliation or ownership, or discriminate against a locally established supplier on the basis that the goods or services offered by that supplier are goods and services of the other Party.

Another general principle is the prohibition of offsets. It says: "An entity shall not consider, seek or impose offsets at any stage of a procurement." Several developing countries make use of "offsets" to reduce the net cost of purchase or payment for goods and services procured.

The agreement includes a provision requiring the entities to publish in advance a notice inviting interested suppliers to submit tenders for that procurement. The notice will include a description of the procurement, conditions for suppliers to fulfil, time limits to submit tenders and delivery dates for the goods to be procured.

There are also many detailed provisions on time limits for the tendering process; provision of information on intended procurements; technical specifications; conditions for participation; tendering procedures; awarding of contracts; domestic review of supplier challenges.

To implement the obligations, a developing country would have to undertake reforms and new procedures.

Most developing countries provide preferential treatment to local suppliers in government procurement. Thus, the most important reform would be to give up this preferential treatment, and to give equal (or superior) treatment to foreign suppliers, in accordance with the FTA. There are many consequences for such a significant change in policy.

There are also many new procedures that have to be followed. For instance, the FTA specifies what kind of conditions can or cannot be imposed on suppliers interested in participating in a procurement. It specifies what kind of tendering procedures should be followed. Importantly, it obliges the country to set up independent review institutions and processes to enable a supplier to challenge the decision on granting of procurement contracts.

Comparison of how the procurement issue was treated in WTO and in the US FTAs

The provisions in the FTA on government procurement go far beyond how the issue has been discussed in the WTO.

The WTO does have an agreement on government procurement, which covers market access. However this is a plurilateral agreement, which members are free to join or not join. Hardly any developing country has joined this agreement, as the developing countries are concerned about the adverse effects of their being members.

The lack of participation of developing countries in this plurilateral agreement prompted them to propose a WTO multilateral agreement on "transparency in government procurement." Their proposal was that the agreement deal only with transparency aspects, thus leaving members the freedom to determine whether or not to grant national treatment for foreign companies. In other words, there would not be a market access component to the agreement.

The Singapore WTO Conference (1996) agreed "to establish a 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." The decision does not specify that there must result an agreement; it only commits Members to set up a working group to study the subject of transparency and based on this study to develop the elements to include in an *appropriate* agreement. I

Before and at Doha, many developing countries put forward the view that they were not ready to negotiate an agreement in transparency in government procurement. However, these views were not adequately reflected in the Doha Declaration. As with the other "Singapore issues", the Declaration (para 26) states that negotiations will take place after the Fifth Ministerial on the basis of a decision to be taken by explicit consensus on modalities of negotiations. The Declaration also states (in para 26) that negotiations will build on progress made in the working group on transparency in government procurement and take into account partricipants' development priorities. Negotiations shall be limited to the transparency aspects and therefore will not restrict the scope for countries to give preferences to domestic supplies and suppliers.

However, the major countries advocating this issue had made clear their ultimate goal to fully integrate the large worldwide government procurement market into the WTO rules and system. At present, WTO Members are allowed to exempt government procurement from WTO market access rules.

Since developing countries have found it unacceptable to integrate government procurement and its market access aspect into the WTO, the major developed countries devised the tactic of a two-stage process: firstly, to draw in all Members into an agreement on transparency; and secondly, to then extend the scope from transparency to other areas (for example, due process) and then to the ultimate areas of

market access, MFN and national treatment for foreign firms. This is clear from various papers submitted by the US and EC to the WTO.

The developing countries were suspicious and concerned that once a transparency agreement is in place, the developed countries would then move to extend the agreement to also cover market access and national treatment. Due to this concern, at the Cancun Ministerial meeting in 2003, the developing countries asked that the issue of transparency in government procurement be dropped from the negotiating agenda. After the Ministerial ended without a decision, the developing countries continued their demand, and in July 2004, the General Council made a decision to drop this as a negotiating issue during the present Doha work programme.

Because of their serious concerns, the developing countries till now have opposed negotiations towards even a transparency agreement on government procurement. Yet the FTAs involving the US contain binding rules on the full market access aspects in the government procurement chapter.

Significant role of government procurement in socio-economic development

A large part of an average developing country's income is made up of the spending of its federal government, on the purchase of goods, payment for all kinds of services, and a variety of projects, from the building of schools and roads to billion-dollar mega-dams and industrial complexes.

Add also the expenditure of state and municipal governments, statutory bodies and state-run enterprises, and the total amount of money spent by the public sector becomes enormous; for many countries, much larger even than their total imports or exports. For example, in some countries, public sector expenditure may comprise 30 to 50 percent of GNP, while imports may comprise 10 to 30 percent of GNP. Even if the salaries of government employees are excluded, government expenditure is often higher than imports.

So far, governments have been able to decide for themselves how this money is to be spent, the system of procuring goods and services, and the tendering, scrutiny of applications and award of projects, subject of course to each country's laws and procedures.

The system of government procurement has been taken for granted as very much a matter of national prerogative, often challenged in some countries by Parliaments, opposition parties or public interest groups, but seldom or never questioned as an issue that lies within the sovereign right of a country to determine.

Because of the senstitive nature of government procurement, government procurement has so far been excluded from the rules (such as national treatment and most favoured nation) of the WTO, including the GATT, agriculture agreement and the services agreement. There is a plurilateral agreement on government procurement; however

members can choose whether or not to join it, and most developing countries have choosen not to do so.

Government procurement and policies related to it have very important economic, social and even political roles in developing countries:

- The level of expenditure, and the attempt to direct the expenditure to locally produced materials, is a major macroeconomic instrument, especially during recessionary periods, to counter economic downturn. Governments often change the level of expenditure as the major tool of fiscal policy to steer the level of demand and growth in the economy.

- In many developing countries, there are national policies to give preference to local firms, suppliers and contractors, in order to boost the domestic economy and participation of locals in economic development and benefits. In fact, government procurement is a major policy tool for putting into effect a policy of increasing the opportunities for local enterprises to increase their share of the economy.

- Also in several developing countries, there are policies aimed at providing preferences for certain groups or communities, especially those that are under-represented in economic standing. Procurement policy is a major policy tool for attaining greater balance in the participation shares among various communities within a nation. Similarly, it can be used to redress regional imbalances, for instance by specifying that certain provinces be allocated a particular share of procurement business.

- For procurement or concessions where foreign firms are invited to bid, there could be a preference to give the award to firms from particular countries (eg other developing countries, or particular developed countries, with which there is a special commercial or political relationship).

Effects of a FTA government procurement chapter on developing countries

Countries that sign on to FTAs containing a chapter on government procurement in future will not be allowed to give preferences to local companies for the supply of goods and services and for the granting of or concessions for implementing projects. The effects on developing countries would be severe.

Should government procurement be opened up through the national treatment and MFN principles, the scope and space for a government to use procurement as an instrument for development would be severely curtailed. For example:

- If the foreign share increases, there would be a "leakage" in government attempts to boost the economy through increased spending, during a

downturn. This is because an increased part of any expansion in government expenditure would be spent on imported products, thus decreasing the multiplier effects of public spending on the domestic economy.

- The ability to assist local companies, and particular socio-economic groups or ethnic communities, or underdeveloped regions, would be seriously curtailed. This is because "national treatment" would have to be given to foreign firms to bid for supplying goods and services as well as development projects.
- The ability to give preferences to certain foreign countries would similarly be curtailed, under the most-favoured-nation clause. [This would be the case if government procurement became a multilateral agreement in the WTO].

Given the great importance of government procurement policy as an important tool required for economic and social development and nation building, it is imperative that developing countries retain the right to have full autonomy and flexibility over its procurement policy.

In the case of Malaysia, government procurement and expenditure has been a major instrument for economic management and for socio-economic planning, as well as political stability among ethnic communities. The levels of procurement, especially if state and local authorities are also included, and if government-related enterprises are included, are very large. Malaysia has made use of the level of government expenditure as a means to influence the level and growth of economic output, for example by boosting public-sector spending during recessionary conditions, thus reducing economic instability. Procurement has been used to expand the opportunities for local enterprises. For example, the use of local banks in government business was a major method of increasing the share of local banks in total banking business, after Independence. Procurement policy has also been a major instrument in increasing the opportunities for the Bumiputra community, for instance in construction projects, within the context of the New Economic Policy and its subsequent variations. Therefore the points above on significance of government procurement and on the dangers of curtailment of the policy space in this area have great application to Malaysia. It is no exaggeration to state that the serious limits and conditions placed on government policy should government procurement be integrated into the WTO, would have very serious social, economic and political ramifications.

Therefore, it is important to consider the option of not including government procurement as an item in a bilateral trade or economic agreement. This is especially so because the developing countries have fought such a controversial battle to exclude this as a negotiating issue within the current Doha work programme in the WTO. At the least, there should be national debates about the ramifications of having a government procurement clause within an FTA.

In an FTA involving a developed and a developing country, it is more likely that the developed country can take advantage of a government procurement market access chapter as it has the supply capacity. Most developing countries will not be able to take advantage, or at least to the same degree, because they lack the supply capacity. Thus there is an inherent imbalance in including this in an FTA.

Background to the attempts to introduce procurement as a multilateral agreement within the WTO

In order to appreciate more fully the context of the procurement issue in current FTA negotiations, it may be useful to recall how this issue was introduced as a subject for multilateral discussion in the WTO.

A decision was taken to establish a working group on "transparency in government procurement" at the WTO Ministerial Conference in Singapore in December 1996. The decision was that the study be confined only to "transparency" in government procurement practices, and evolve elements of an agreement on this limited theme.

But the prime mover of this initiative, the United States, had made it clear that in its scenario, this is only a first step towards a full-scale opening up of the "market" for government procurement for foreign companies. With the support of the European Union, the US has planned that an "interim" agreement on transparency emerging from this working group will eventually be upgraded into a full-blown agreement on government procurement practices.

This would give "national treatment" rights to foreign companies (to have the same chance as locals to bid for and win public-sector contracts), and "most-favoured-nation treatment" rights to all WTO countries (to be treated in a non-discriminatory way in the procurement awards).

The game-plan of the US and EU on the government procurement issue was candidly presented to WTO members at its so-called heads of delegations (HOD) process in Geneva in the months of 1996 in preparation for the first Ministerial Conference.

The US administration had in fact initially brought the issue up using the term "corruption". When the then US Trade Representative, Mickey Kantor, raised the issue as one interfering with market forces and distorting the market, the WTO Director-General Renato Ruggiero promptly agreed to push it in the WTO. The deputy US trade representative, Jeffrey Lang, proclaimed "corruption" as the "single greatest non-tariff barrier". He made it clear at a WTO General Council meeting in December 1995 that corruption in business and contracts was a priority issue for the US to introduce at the Singapore Conference.

By bringing up the issue as being aimed at "corruption", the US sought to exploit widespread moral indignation at the growing number of cases of development projects involving public corruption. But the US gave only a narrow interpretation to the term and soon moved away from this --- since a wider connotation could bring into question many of the practices in the US itself, including the way US corporations and lobby groups contribute funds to election campaigns or to elected officials to gain leverage for their interests.

Perhaps because of the negative response that the term "corruption" inspired among developing countries which protested against yet another "non-trade" issue being linked to WTO as a possible trade conditionality, the discussion on the same issue at the WTO preparatory process switched to "transparency, openness and due process" of government procurement practices.

In the draft Declaration crafted by WTO Director General R. Ruggiero for the heads of delegations process before the Singapore Ministerial, government procurement was included as one of the new issues for the WTO's future work programme.

Despite the objections of several delegations of developing countries in Geneva, Ruggiero not only brought the issue to Singapore but strengthened the text. The draft Declaration, presented by him and discussed by Geneva diplomats, as of 20 November, had Ministers agree to "establish a group to develop an interim agreement on government procurement in order to improve transparency and due process in government procurement procedures."

In his 29 November 1996 letter to the Conference Chairman, Singapore Trade Minister Yeo Cheow Tong, Ruggiero had changed this to: "Establish a group to conduct a study and develop a multilateral agreement on principles related to transparency of government procurement practices, with reference to domestic rules on bidding, announcement of procurement opportunities and provisions for independent review, to apply on a non-discriminatory basis."

The Director-General noted that "some Members cannot join a working consensus to begin work on this item. Others are willing to do so if some alterations are made to the text."

As with other new issues (labour, investment and competition), this issue was negotiated in an informal group of 30 countries. The developing countries that had earlier in Geneva resisted all new issues from entering the WTO eventually expressed willingness for a working group on transparency in government procurement to be established.

The final Declaration text on this issue states that the Ministers agree to "establish a 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."

Developing countries appear to have accepted the decision because the working group, and the reference to an agreement, refers only to "transparency" in procurement practices. In other words, the implied commitment is to make procurement practices more transparent (for instance, through greater information flows) but does not include changing or disciplining the practices, such as giving preference to local companies and limited access to foreigners.

However, the post-Conference statements in Singapore by the US and EU made it very clear that for them the working group is only an interim measure and a means towards

their ultimate goal of multilateral rules to ensure full access for their companies to the multi-billion dollar government procurement business in developing countries.

The US Trade Representative Charlene Barshefsky said: "The study on procurement is intended to be the first step toward an agreement on transparency practices in government procurement which should serve to reduce the influence of corruption. This initiative will, as we continue to push it, help create an environment where businesses can expect a fair shake in competing for contracts with foreign governments."

The EU Commission Vice-President Sir Leon Brittan was equally if not more direct: "We have agreed to a study on transparency in government procurement. Europe is determined to see the proposed study forming the basis of a wider multilateral agreement providing for non-discrimination in government procurement."

Thus, as far as the major countries are concerned, the transparency issue is only a first and tactical measure to draw developing countries, step by step, into the larger area of national treatment for foreign firms to obtain contracts for government procurement and projects.

The developed countries have not attempted to hide this goal. In the heads of delegations process in Geneva in 1999, the US and EU papers on the subject made clear they considered government procurement to be a gigantic business which had hitherto remained outside the WTO's ambit and should be brought in through multilateral rules so that their companies could have full access to the developing country markets.

In its first paper in March 1996, the US pointed out: "Procurement markets worldwide account for trillions of dollars in commercial transactions. Large, commercially attractive procurement occur at all levels of government." It cited as examples: municipal government procurement for police, fire departments and local public works; provincial government procurement for health and social security programmes; central government procurement for national telecommunications networks, electrical power grids and transportation systems.

The problem, said the US, is that although governments are the largest purchasers of goods and services in the world, procurement activities are not subject to basic WTO rules on market access and national treatment, except for the plurilateral Government Procurement Agreement (GPA). It viewed the result as an environment in which anti-competitive behaviour can distort the market.

It then proposed that "without debating the present WTO rules on procurement, WTO members can create an environment for greater market access opportunity by taking steps to address the lack of transparency, openness and due process that characterises much of procurement worldwide."

The US saw the opportunity to use the Singapore Ministerial Conference to consider "how to develop an agreement that can be fully incorporated into the WTO's single undertaking and include both goods and services."

The US felt that a long term objective for current GPA signatories is to expand the coverage and membership of this Agreement, but this "should not preclude, however, efforts among all WTO members immediately, to address the problems exporters are facing around the globe in their ability to compete for substantial market access opportunities in procurement of goods and services."

It recognized that whilst it was desirable to simply multilateralize the current GPA, this was not possible in the short-term. Nevertheless, the Singapore Ministerial Conference "should give direction to the WTO that will put government procurement on the path to an eventual comprehensive multilateral agreement."

The US then proposed that "recognizing the urgent need to establish a more competitive and predictable bidding environment, a first step could be to achieve an agreement that focuses on transparency, openness and due process, setting the stage for progressive application of national treatment obligations."

It said an interim agreement on this basis "would improve the environment for bidding worldwide and address the real and growing concerns of our exporters immediately."

In a second paper in June 1999, the US said a Singapore Ministerial mandate for negotiating an interim arrangement must be without prejudice to WTO members' positions on membership to the exisiting GPA; and the negotiations should take account of developments in other WTO fora, especially the GATS Rules Group and the Government Procurement Committee.

It proposed the interim arrangement cover both goods and services and in principle, should apply "across the board to all government procurement," recognizing the variety of governmental structures.

The US then proposed the following elements of an interim agreement:

- It should focus on principles of transparency, openness and due process in government procurement practices. Once in place, they would apply equally among all WTO members on a non- discriminatory basis.
- While it should establish basic procedural guarantees available for all WTO Members, as a first step it would not address existing preferential or discriminatory procurement requirements.
- It should have procedural guarantees that increase information flow on procurement opportunities. Foreign suppliers should have access to information on what entities are procuring in their sector, notification of specific procurement opportunities and guarantees that all suppliers will have access to the same information on an equal basis. It should provide for review mechanisms when disputes arise.
- It should provide new information bases on government procurement practices of WTO Members. Compiling such information "will be key to future efforts to integrate government procurement into the WTO, which is likely to proceed in

> stages, just as the lowering of tariff barriers has required a series of negotiations."

The paper concludes: "Government procurement accounts for a substantial value of commercial activity in all countries... Literally trillions of dollars annually are spent by governments in procuring goods and services. Transparency, openness and due process are important first steps because they provide vital information to foreign suppliers on the circumstances under which they may bid on contracts. They will help to create greater certainty as to the likelihood of winning contracts. Future steps towards full integration will generate increased opportunities for suppliers to compete on an equal basis in government procurement markets worldwide."

The above conclusion of this paper shows, in a nutshell, the US view of the role of the working group and the interim agreement as part of a strategic plan for a stage-by-stage integration ("staged-integration", in its term) of government procurement practices into the WTO system.

A third paper in July further reiterates that the proposed agreement ("an interim arrangement") is to be "a FIRST STEP in the integration of government procurement into the multilateral system." (Emphasis as in original). It also stresses there should be no exemption or lower standards for developing countries nor LDCs:

> "The US and others have proposed commencing integration of procurement into the WTO by focusing first on transparency, openness and due process. These are fundamental principles on which further market liberalization must be built. These principles would apply equally to all WTO members irrespective of their level of development, just as current transparency provisions in the WTO are obligations undertaken by all countries."

Interestingly, the paper also says the principles in an interim arrangement should be flexible enough to accommodate a variety of existing national procurement regimes. This could explain why the additional wording proposed by some developing countries in the Declaration, "taking into account national policies", could be accepted by the US as it had already accomodated this point.

A separate paper by the EC during the Geneva preparatory process equally clearly laid down its aims:

> "The EC fully supports Ministers taking decisions during their conference in Singapore which lead to define ways and means (including the launch of new negotiations) to reduce or eliminate trade distortive effects of domestic government procurement measures of all WTO members. In this regard, the EC welcomes a parallel process of negotiations which would (1) enhance the disciplines and expand the number of countries subscribing to the GPA and (2) develop an interim arrangement on transparency, openness and due process in government procurement practices. An interim arrangement should focus on basic principles of transparency, openness and due process in government

> procurement practices on the understanding that the Community's final objective is to achieve national treatment and MFN effectively for all government procurement in all WTO member countries."

The EC paper is also illuminating in the types of policies it considers "trade distortive" and which, by implication, should be outlawed in a future multilateral agreement on procurement. The paper states that "GATT Art III.8 exempts government purchasing of products from multilateral rules, leaving governments free to maintain government procurement measures and practices which are trade distortive...In the absence of clear multilateral rules, billions of dollars worth of trade will continue to be subject to domestic rules and procedures not covered by the WTO framework. It is estimated that public purchasing can represent up to 15% of GDP."

The reasons for this exception, it says, are diverse: "sectoral objectives, sovereignty concerns, desire to control tax contributions." The EC says that the exception is achieved through explicit measures in national policy and legislation, and less explicit measures.

Among the explicit measures mentioned by the EC paper are: "prohibitions to purchase foreign goods and services, "set asides" or price preferences for domestic producers, minimum local content requirements, mandatory offsets and/or technology transfers." The EC says that all of these "distort trade and contradict the overall need to acquire goods and services on the best possible terms."

The less explicit measures or practices which the EC says "also discriminate" include: "excessive recourse to single or selective tendering (eliminating opportunities for foreign suppliers), biasing the setting of technical specifications to favour specific goods or suppliers, providing insufficient notice for foreign suppliers to respond, or simply exercising the procurement decision maker's discretion to choose local."

The EC paper says opening up competition to foreign goods and suppliers and service providers can "help reduce government expenditure, stimulate domestic industry, promote innovation and reduce the incidence of bid-rigging. This approach also eliminates a source of trade distortions."

The EC welcomes and supports all efforts to rectify "this flaw" in the WTO system. "The final objective should be to ensure that effective national treatment and MFN principles apply to all government procurement in all WTO members."

There can be no doubt, therefore, that where the EC and US are concerned, what was decided on in Singapore was an initial step (an "interim arrangement") on the road to full access and national treatment for their companies to the government procurement business, especially of developing countries.

Developing countries should thus be under no illusion that the decision they agreed to in Singapore is of small or limited consequence because it has only committed them to negotiations on transparency and procedures and that the matter will then rest there. What the major countries especially want to see eradicated in developing countries are the types

of government procurement policies and practices that currently favour local enterprises and people --- practices that the major industrialized countries had followed not too long ago within their countries and which had benefitted some of their giant corporations.

These policies are adopted in most developing countries in order to help build the domestic sector, strengthen domestic linkages and demand and support local entrepreneurs. Since liberalization is proceeding so rapidly in other areas, government expenditure remains one of the few (and probably the most important) sectors of economic activity which can be used as an instrument to boost local business and domestic demand.

This crucial "development dimension" is however lost in the "market access paradigm" adopted by the proponents of fully integrating government procurement in WTO rules and dispute settlement systems.

Subsequently, the 2001 Doha Ministerial meeting of the WTO mandated that negotiations should start on an agreement on transparency in government procurement at the next Ministerial of 2003. The working group intensified its discussions in 2001-2003. However, the Cancun meeting ended without any decision. In July 2004, the WTO General Council decided that further discussion on this issue be suspended during the rest of the Doha work programme period.

The above background to the start of the discussions at the WTO and the subsequent developments show how the developing countries had continued to fight to keep the procurement issue off the agenda for creating multilateral rules in the WTO.

This is probably the reason why the developed countries have shifted the venue for this issue to the FTAs.

It is important for developing countries to consider whether to agree to include this issue in FTAs that they are negotiating.

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