

**INTERNATIONAL DISCIPLINES ON GOVERNMENT PROCUREMENT:
A REVIEW OF ECONOMIC ANALYSES AND THEIR IMPLICATIONS¹**

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1. Introduction.

All over the world state agencies 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 is also one of the principal interfaces 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 views a country's governance and investment climate. As well as having a direct

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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 levels 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 motivate their decisions to interested parties.⁴ 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 directly 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

⁴ Specifically, article 187 of the Constitution of the Republic of South Africa states:

“(1) The procurement of goods and services for any level of government shall be regulated by an Act of Parliament and provincial laws, which shall make provision for the appointment of independent and impartial tender boards to deal with such procurements.

(2) The tendering system referred to in subsection (1) shall be fair, public and competitive, and tender boards shall on request give reasons for their decisions to interested parties.

(3) No organ of state and no member of any organ of state or any other person shall improperly interfere with the decisions and operations of the tender boards.

(4) All decisions of any tender board shall be recorded.”

Source: <http://www.ffc.co.za/about/intconst/consti12.asp>

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 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.⁵

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.⁶ The GPA has been renegotiated a number of times since the end of the Tokyo Round (1979), greatly increasing its substantive coverage.⁷ 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

⁵ The list of members of the Uruguay Round GPA can be found at http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm.

⁶ The text of this Tokyo Round agreement can be downloaded at <http://www.worldtradelaw.net/tokyoround/procurementcode.pdf>.

⁷ The text of the Uruguay Round GPA can be downloaded at http://www.wto.org/english/docs_e/legal_e/gpr-94_e.pdf.

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, demandeurs (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. However, agreement to launch negotiations on even this limited agenda proved impossible at the WTO Ministerial Meeting in Cancun in September 2003. Recently, the July 2004 Framework Agreement among WTO members effectively ends 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 remain 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 review and multilateral enforcement mechanisms. Here we shall not review the legal provisions of the GPA here; for that see Blank and Marceau (1996) or Arrowsmith (2002). Instead, 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.

The remainder of this paper is organised as follows. The next section describes some of the principal lines of thinking that have fostered and, in some cases, impeded the reform of national procurement policies. This section provides important historical and national context for the subsequent discussion. The third section describes the so-called targets and instruments of national procurement policy, highlights the various ends and means of state action in this policy domain. The fourth section of this paper summarises the main findings concerning the size of national procurement markets and the extent of discrimination against foreign bidders. The fifth section provides an intuitive account of the principal economic analyses of the effects of procurement discrimination and the lack

of transparency in implementing public procurement procedures. The final section of this paper considers the implications for future international rule-making on public procurement of the evidence and analyses presented in this paper.

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 protectionism⁸. 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 General Agreement on Tariffs and Trade. 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 Agreement of Government Procurement (GPA) was strengthened. Three factors underlie this shift towards greater acceptance of international rules on national procurement practices.

⁸ For other political economy rationales for reform see Hoekman (1998).

First, since the mid-1970s government budgets have come under increased pressure, especially in industrial nations. Spending on welfare states, health, education, and pensions have 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 Agreement on Government Procurement 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.

⁹ OECD (2003) notes in this regard that, "...it should be stressed that some of the reforms needed cannot be implemented at no cost, but require resources to build up capacity and initiate long term change. Indeed, resources are required to change the institutional set-up (eg. the cost of making legislative changes and training the necessary staff) and to maintain procedural requirements to ensure transparency and due process" (page 11).

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 that 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 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, in which case 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 section 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 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 that 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 inflate the bids of disfavoured suppliers. For example, a ten percent price preference against foreign suppliers implies that their actual bids will be inflated by ten per cent before being compared to bids 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.¹⁰ 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.

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.

¹⁰ This argument is developed at length in Mattoo (1996).

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 foreign direct investments, 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 other two modes of supply relate to the movement of people across national boundaries. To effectively supply 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 themselves 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 investments) 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 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 there must be repeated tendering by the state over time, so holding out the prospect of future contracts for those engaged 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 national 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 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 from 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.

On average, in the OECD nations government procurement on items other than defence and compensation for state employees entails outlays equivalent to 7.57 percent 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, between a quarter and a third of those outlays are undertaken by central governments, highlighting the importance of sub-national authorities.

Turning to the economies that are not members of the OECD, OECD (2001) reports that on average their contestable government expenditures amounted to 5.10 percent of their national incomes. The total amount of such expenditures in these non-OECD nations equals US\$287 billion, approximately one-sixth of the size of the contestable procurement markets in OECD nations. Moreover, the size of the contestable procurement markets in non-OECD nations is highly skewed: 60 of the 106 nations have procurement outlays less than US\$1 billion. In 1998, around 10 non-OECD nations have contestable procurement outlays of US\$10 billion or more.

The fact that so many non-OECD countries have relatively smaller contestable procurement outlays does not imply that state procurement is unimportant in these economies. However, the magnitude of their state outlays does suggest that in absolute terms the maximum size of market access to their procurement markets is far more limited than in the OECD nations and in a few of the larger non-OECD countries (Evenett 2003).

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)

4.1. The Extent of Discriminatory Policies.

The full extent to which governments discriminate in their procurement policy is not known. To the best of our knowledge comprehensive and comparable cross-country data on such discrimination has not been collected. However, much is known about individual policies of countries, especially members of the GPA. The *WTO Trade Policy Reviews* often provide useful information on the degree of preferences awarded to different types of domestic firms and on the proportion of contracts sourced abroad.¹¹ Many countries maintain policies that either ban foreign sourcing for some types of goods and services, or that give domestic bidders a price preference. For example, Israeli firms that are competing in a tender against firms that are not located in GPA members receive a 15 percent price preference. Available data also reveal that 90 percent or more of all procurement contracts may be allocated to domestic firms, even in countries where the trade to GDP ratio is very high. Thus, to give another example, the number of contracts awarded to foreign firms by Norwegian procuring entities during 1996-1997 did not exceed 6 percent (Evenett, 2003). A recent Trade Policy Review for Japan reports by type of good that nations government's purchases from abroad. Of the 769 billion yen of reported procurement expenditures, 16.1 percent was awarded to foreign firms. A number of country cases are discussed in the papers included in this volume—see also Hoekman (1997), Evenett and Shingal (2002), Francois et al (1997), Gordon et al (1998), Srivastava (2003), Choi (2003) and Mardas (2001). So it would be seem that discrimination in procurement policy is widespread. This raises the question as to the economic consequences of such discrimination, to which we now turn.

5. Economic impacts of policy and international policy disciplines.

Economic research differentiates between two types of question: what is the effect of a specific government measure on market outcomes? And what is the effect of that measure on national welfare, which aggregates the benefits that purchasers (including the government) and suppliers derive from market exchange? As is often the case, the

¹¹ Recent *Trade Policy Reviews* conducted by the WTO secretariat can be downloaded from http://www.wto.org/english/tratop_e/tpr_e/tpr_e.htm.

scholarly attempts to answer these questions have used both partial (single market) and general equilibrium methods.

5.1. General equilibrium analyses.

One effect of discrimination against foreign suppliers is on the levels of demand for different goods and on the inputs that are used to make them. Suppose that a government decides to no longer buy a certain good from abroad. This will raise the relative price of that good (the price of that good compared to other goods) because the additional resources that favoured domestic firms need to use to satisfy the government's higher demand for their products must be lured away from other productive resources. A procurement ban thus will affect the payments to factors of production, such as land, labour, and capital. The factor of production that gains (loses) from the imposition of this procurement ban is the one which is used most (least) intensively in the production of the good that the government is now buying solely from domestic firms. *The first knock-on effect of procurement discrimination in the domestic goods market is felt in domestic labour and capital markets.*

A second knock-on effect is on the quantity of exports and imports. There are two mechanisms at work here: one which works through relative prices and one that works in industries where higher output levels translate into higher productivity levels. For example, the imposition of a procurement ban on foreign steel raises the relative price of steel. If the nation was exporting steel before the procurement ban, then the ban will raise the relative price of steel to all purchasers—including foreigners—leading to a fall in domestic exports. If the nation was importing steel before the procurement ban is imposed, then the increased relative price of steel would reduce the total (government plus private sector) domestic demand, and therefore, imports of steel. In both cases, the total quantity of steel traded internationally falls as a result of the procurement ban. More importantly, both cases involve the relative world price of steel being affected by the procurement ban. Not many nations are likely to have such clout over the world price of even a few goods.

Even if countries cannot affect their terms of trade, if firms confront economies of scale (output per worker employed and output per machine rise when production is

higher) a procurement ban can also affect exports. A ban in this case results in government switching demand for foreign to domestic producers. If this increases output, incremental production costs per unit produced fall. This increases the incentive for domestic producers to expand sales to other markets—including the export market. In sum, the procurement ban can increase exports as well as domestic production of the good concerned. In any event, whatever technologies firms employ, it is quite possible for a domestic procurement ban to have knock-on effects in export markets.

5.2. Partial equilibrium analyses.

Most analyses of procurement discrimination have examined the effects on outcomes in a single market. The essential feature of these analyses is that there are two sources of supply (domestic and foreign) and *two sources of domestic demand* (the government and consumer). The principal finding, first derived by Baldwin (1970) and fully developed in Baldwin and Richardson (1972) which may seem a little counterintuitive at first, is that a procurement ban on foreign purchases by the government will affect output levels, imports, and prices only if government demand exceeded domestic supply at the moment the ban was imposed. An example will make this a little clearer: Suppose that in the market for cars before the procurement ban was imposed, government demand was 60 cars, private sector demand was 40 cars, the domestic private sector supplied 45 cars, and 55 cars were imported. Initially, then the government must have imported at least 15 (60-45) cars. So at the prices that prevailed before the ban was imposed, government demand exceeded domestic supply. In this case, when the ban is imposed the price of cars paid by the government must increase to encourage domestic supply to expand to meet government demand. At this higher price government demand equals domestic supply at, say, 52 cars. In which case, government demand has fallen by 8 cars, domestic production has risen by 7 cars, and imports have fallen by at least 15 cars.

The effect on the domestic (non-governmental) consumers depends critically on whether the initial pre-ban price was determined by world prices or by domestic market forces. If the world price determined the pre-ban price, then the domestic consumers are unaffected by the procurement ban. After all, domestic consumers do not need to pay the higher post-ban price charged to domestic government, as they can buy all the cars they

want on world markets at the world price. In contrast, if foreign producers customise their cars to the domestic market, the procurement ban leaves foreign producers with at least 15 cars which they used to sell to the domestic government but are now prevented from doing so. Since these cars were customised for a specific market (suppose they have steering wheels on the left hand side), then the possibility of selling these cars on the world market is remote. The foreign car suppliers are left with little choice but to offer additional cars to domestic consumers at lower prices. In this case, domestic consumers actually gain from a government ban on purchases from foreign cars—as the ban creates a temporary surplus of foreign goods which results in lower prices being paid by domestic consumers.

The arguments in the last two paragraphs considered the case when the government demand for cars (60 in this case) exceeded domestic private sector supply (45) at the time the procurement ban was imposed. Now, suppose that government demand was less than or equal to domestic private sector supply, then the imposition of a procurement ban would have *absolutely no effect* on imports, output, or national welfare. To see this, the preceding example need be changed in just one respect—assume now that before the ban is imposed government demand is 45 cars and domestic private sector supply is 60 cars. (Everything else in the example is as before.) In this case, the procurement ban would merely reshuffle demand between foreign suppliers and the domestic producers of cars. To see why, suppose originally the government bought 5 cars from abroad then those 5 cars must now be supplied by domestic firms, which in turn would have 5 fewer cars to supply the domestic consumers. However, foreign firms have exactly 5 unsold cars which they can now supply to domestic consumers, making up any apparent shortfall. Therefore, when government demand is relatively small, a procurement ban merely reshuffles sales between domestic and foreign firms, with no effect on overall imports (market access), output, or prices.

Unfortunately, the clear-cut nature of these predictions only provide a test of whether the *future* imposition of a procurement ban will affect market outcomes; specifically, a procurement ban on a good by a nation's government will only affect market outcomes if the level of government demand before the ban exceeds domestic private sector supply. This test, however, yields no information as to whether an *existing*

procurement ban restricts market access to foreign firms. More constructively, if government demand after the ban is imposed is less than domestic private sector supply, then the argument in the last paragraph applies and removal of the ban will have no effect on market outcomes, including imports. However, if observed government purchases equal the quantity supplied by the domestic private sector after a ban is imposed, then one cannot tell if the ban has distorted market outcomes. This is because this equality could have prevailed before the ban—in which case the imposition of the ban would have had no effect on imports. Thus, this simple test does not always provide a reliable guide about the market-access reducing effect of an existing *de facto* or *de jure* procurement ban.

In sum, this framework is useful as it implies that procurement discrimination effectively segments the domestic market into a market to supply domestic government and a market to supply other domestic customers. The domestic government forgoes the benefits of foreign competition and may pay a higher price and purchase few units—if its pre-ban demand was relatively large (compared to domestic supply). Domestic producers can gain (only if they have to coaxed into supplying goods more with higher prices) and the effect on domestic consumers depends on whether domestic prices were initially set by world prices or by domestic market forces.

5.3. Allowing for firm entry.

The Baldwin-Richardson framework described in the last section has been extended to consider the implications of firm entry (Evenett and Hoekman, 2004a). In the case where procurement discrimination raises the price paid by the government, domestic firms expand output and see their profits rise. As is typical in a market economy, profits act as a signal to entrepreneurs who are deciding which industry to set up production in. New “domestic” firms want to enter this protected industry—and if they do, then the number of firms who can supply the domestic government increases, and the price paid by the government will tend to fall until the incentive to enter this market (the higher-than-usual profits) has gone. Indeed, the principal consequence of allowing free entry into the market is that the price paid by the government may now fall to equal the world price—potentially eliminating any price wedge between that paid by consumers and that paid by the government.

Whether entry occurs depends on the prevalence of natural—and policy-induced barriers—to entry. Entry by domestic entrepreneurs may be frustrated by rules, regulations, and licensing. Entry by foreign entrepreneurs, that could set up production facilities in the nation which has imposed the procurement ban, depends upon a slew of policies towards foreign direct investments. Therefore, the long term consequences of a procurement ban are determined in part by domestic competition policies and restrictions on foreign direct investments. The fewer the barriers to entry the smaller the difference between the prices paid by the domestic government and by the domestic consumer, and the smaller the distortion to government consumption decisions. However, if the new entrants have long run costs of production than exceed those of overseas producers, then the elimination of the procurement ban will still improve market access—that is, if domestic suppliers cannot take steps to lower production costs in the face of increased foreign competition.

5.4. Corruption

Another important consideration is the effect of corruption and bribery on the benefits of procurement liberalisation. It has been widely acknowledged that corrupt government officials can solicit payments from actual and potential suppliers of goods and services to the public sector. Naturally, the nature and extent of corrupt practices differ across the world, and it is impossible to give a comprehensive account of corruption in the space available here. Instead, the focus here is on two distinct lines of argument developed in Evenett and Hoekman (2004a). There are two cases to consider: the impact on procurement and procurement reform when a corrupt government official takes bribes in a transparent fashion and the case when a corrupt official shifts government expenditures towards goods where the procurement process is relatively more non-transparent, which in turn facilitates the collection of bribes.

The first case assumes that a procurement official cares about two factors: the quantity of goods that the official's government agency buys (which is associated with size of its agency and the prestige of the agency), and the benefit the official derives from spending any income it receives as bribes from the firms which supply its government agency. Now suppose that these firms can also sell in the world market at a price of \$1.

This means that these firms' revenues from supplying the government, net of bribes paid to the official, can never fall below \$1, otherwise the firms would concentrate on supplying the world market. The official has to decide what bribe $\$b$ (per unit of good sold to the government) has to be paid by the firms. Competition among the firms ensures that they charge the government $\$(1+b)$. In making its choice the official knows that a lower bribe will increase the quantity that its agency purchases, which increase the official's welfare, but may reduce its total income from graft. The official will choose that bribe level which equates the incremental benefits of the former to the incremental benefits of the latter. Under quite standard assumptions on the official's preferences, this will result in positive bribes being set. (A bribe of \$0 would, of course, result in no income from bribery.) Now the corrupt official does not, in this set up, really care whether a domestic or foreign firm pays the bribe, so long as the bribe is paid. Therefore, it is perfectly possible for a corrupt official to buy some goods from abroad.

Bribery raises the price paid by the government and reduces the quantity purchased. The reduction in the quantity purchased also determines whether or not the *subsequent* imposition of a procurement ban has any effect. The following example underlines this point. Suppose that the government only decides to buy 5 units of a good when the official is corrupt. Before the procurement ban is imposed those 5 units were supplied by both domestic and foreign firms. If the domestic industry supplies more than 5 units to all buyers when bribery occurs then, just as Baldwin and Richardson found, a procurement ban merely reshuffles demand between domestic and foreign suppliers. This is because the domestic firms need not change their production plans in order to meet all of the government's demand. Furthermore, the greater is the reduction in government demand due to bribery, the higher the likelihood that a procurement ban has no effect.

However, if the domestic firms initially supply less than 5 units, then the imposition of the procurement ban will result in government demand exceeding these firms' pre-ban output. To meet the government's demand the domestic firms have to expand output and can only be induced to do so if the price (charged to the government) rises. Just like the Baldwin and Richardson model, procurement bans can distort market outcomes. However, in this framework the greater the effect of bribery on government

demand, the less likely is a subsequent procurement ban to distort prices, outputs, and market access. (Notice that the argument does not need to invoke non-transparency in order to come to this finding.)

The other case noted above involves an additional realistic wrinkle: that the procurement processes for differentiated products tend to allow for more discretion by procurement officials—potentially presenting opportunities for corrupt officials to collect bribes. A growing body of empirical literature on the nature and effects of corruption in procurement settings has found that corrupt officials deliberately expand expenditures on goods and projects—such as aircraft and construction—which are highly differentiated and for which there are few, if any, comparable reference prices in world markets. This finding suggests that the composition of government spending is shifted towards goods and services that have relatively less transparent procurement processes. Moreover, to the extent that non-transparent procurement procedures reflect the desire to collect bribes by corrupt government officials, then the willingness of firms to supply the government's needs will also be smaller than it would otherwise be. These two stylised facts can be used to analyse the effects of *successfully* eliminating non-transparency in procurement procedures, perhaps as part of an international trade agreement. Evenett and Hoekman (2004a) argue that such an agreement would shift government demand away from more differentiated towards more homogenous goods, and would increase the number of firms willing to bid to supply differentiated products. In most of the cases analysed in their paper, Evenett and Hoekman (2004a) found that the demand for imported differentiated products would fall—suggesting that eliminating transparency need not raise foreign market access in total.

5.5. Economic analyses of procurement discrimination in auctions.

In the analyses of procurement discrimination in markets outlined so far in this section, the discrimination never resulted in a fall in the market price paid by the government—underpinning the presumption that zero discrimination maximises both government purchases and the benefits derived from scarce government resources. However, many government purchases are not made through markets, but are made after procuring entities seek bids from suppliers. The question arises as to whether this presumption

carries over to so-called procurement auctions where there are only a small number of bidders.

Typically, in such situations each firm submits a bid price at which it is willing to complete the contract and also takes into account the price it thinks other firms are bidding for the contract. If the price paid to the contractor were the only consideration, the government would choose the bid with the lowest price. Economists have developed theories of auctions to examine such bidding behaviour; the discussion here concentrates on what these theories imply about the effects and desirability of discriminating against one class of bidders (specifically, foreign bidders). The first finding is that outright bans on foreign bids unsurprisingly reduce the competition faced by each domestic bidder, that in turn all submit higher bids. The government then finds itself choosing from a range of higher bids, and the overall cost of the contract rises. This finding establishes a strong presumption against forms of discrimination that exclude foreign bidders, and evidence from simulated auctions first reported by McAfee and McMillan (1989) in a path-breaking paper implies that restricting the number of bidders (from any source) considerably increases procurement costs.

A second finding is that any measure that increases the cost of one group of bidders results not just in that group raising their bids (or possibly not bidding at all) but also in other bidders raising their bids too. This is because each relatively favoured bidder takes into account the higher prices that the disfavoured bidders are expected to submit and raises their bid by a smaller percentage, so increasing *both* the probability that one of the favoured bidders wins the contract and the profit-margin made in that eventuality. As every bidder submits higher prices, the government will see its procurement costs rise. This outcome could be result from *de facto* discrimination against foreign bidders. For example, suppose that a government decided that all bidders for state contracts—both domestic and foreign—must incur costs to verify that they can meet or have met certain domestic health and safety standards. Furthermore, assume that even though domestic firms faced the same requirements the latter are enforced less rigorously for domestic firms. This asymmetric enforcement would effectively discriminate against potential foreign bidders by raising their costs. This would result in higher bids by all firms—domestic and foreign—and higher procurement costs. In simulations of such procurement

auctions, Deltas and Evenett (1997) found that such *de facto* “cost” discrimination against foreign firms can raise procurement costs significantly. However, comparing their findings with McAfee and McMillan’s simulations, the outright prohibition on foreign bidding tends to raise the expected procurement outlays more than cost discrimination.

A third finding differs from the first two in that one form of discrimination—price preferences—can actually lower procurement costs. McAfee and McMillan (1989) demonstrated this result in an analysis of optimal procurement auctions. The significance of this finding is that it undermines the presumption that a procurement official that seeks to minimise state outlays would always choose not to discriminate against any bidder, domestic or foreign. To understand the intuition underlying McAfee and McMillan’s result it is important to bear in mind two points. First, just as in the last paragraph, in most analyses of auctions, if one supplier raises its bid then other suppliers have an incentive to raise their bids too. The second point relates to the manner in which price preferences work. A price preference is only used to inflate the actual bids of foreign suppliers when comparing domestic and foreign bids. If a foreign supplier’s inflated bid is still the lowest, then the government awards the contract to that foreign supplier but only pays an amount equal to that stated in the winning bid. For example, suppose there is a 10% price preference for domestic firms. If a foreign supplier bids \$10 for a contract, then for the purpose of comparison with domestic bids the domestic government treats the foreign supplier as if it had bid \$11. Now if \$11 is the lowest amount that any supplier bids, then the contract is awarded to the foreign supplier and the latter is only paid \$10 (the actual pre-inflated bid).

McAfee and McMillan’s insight was to show that foreign firms set their bid prices knowing that a price preference will be used to inflate their bids. Foreign firms respond to high price preferences by lowering their actual bids, but not by enough so that their inflated bid falls. What is more, foreign firms accept a larger reduction in their profit margins as price preferences become more stringent. The inflated bids of the foreign firms reduce how much competition domestic firms effectively face. Since the price preferences raise the foreign firms’ (inflated) bids, then domestic firms respond by raising their actual bids and, therefore, their profit margins. The effect of higher price

preferences on procurement costs is ambiguous; however, if the probability of a foreign firm making the lowest bid is high, then increasing price preferences might actually reduce procurement costs because the actual amount paid by the government to any successful foreign bidder has gone down. In particular, McAfee and McMillan (1989) show that if the foreign firms have on average lower costs than domestic firms, then an increase in price preferences from zero will always reduce procurement costs because, under these circumstances, the probability of a foreign firm still winning the contract is so high.

In procurement auctions, domestic firms benefit from higher price preferences, because their profit margins expand if they win the contract and, so long as they do not increase their bids too much in response to the higher preferences, the probability of one of them winning the contract increases too. In sum, McAfee and McMillan (1989) show that, compared to setting no price preference, there is a certain range of price preferences that will result in lower procurement costs for the government and higher expected profits for domestic firms.¹²

But how much of a reduction in procurement costs can be accomplished by using price preferences? Both McAfee and McMillan (1989) and Deltas and Evenett (1997) found in simulations of auctions that the cost reductions were very small (often less than 1%). Worse still, Deltas and Evenett (1997) found that if the government accidentally chose the wrong rate of price preference then these cost reductions would quickly become cost increases—even for small errors. This is particularly important as policy makers do not typically have access to all the relevant information (including the actual probability distributions of the costs of the domestic and foreign firms) to choose the optimal price preference. And even if they did, political factors would probably “encourage” policymakers to choose a higher-than-optimal price preference which benefits domestic firms. Indeed, Deltas and Evenett’s simulations imply considerable gains in the expected profitability of domestic firms result from even quite modest (5-10%) price preferences. Overall, even though McAfee and McMillan (1989)

¹² McAfee and McMillan also show that if the government is prepared to trade off higher procurement costs against higher domestic profits, then the government should always impose price preferences. It is always possible to find a price preference that increases domestic firm’s profits more than such preferences raise procurement costs—see also Branco (1994).

demonstrated in theory that it is possible to reduce procurement costs by imposing price preferences, in practice the reductions are very small and given the realities of policy making will almost certainly never be realised. This form of procurement discrimination is bad policy too.

One final point is that, comparing across simulations of procurement auctions, three types of procurement discrimination in auctions can be clearly ranked in terms of their adverse consequences for procurement costs. Price discrimination tends to have the least adverse effect, followed by *de facto* cost discrimination, which in turn is less distortionary than outright bans on bids from foreign suppliers (or *de facto* measures that have the effect of eliminating all bids from foreign firms). Given these findings, it is noteworthy that the current WTO Agreement on Government Procurement Agreement has strong measures against *de jure* discrimination—such as price preferences—and effectively imposes much weaker disciplines on *de facto* discrimination, which can result in the other two forms of procurement discrimination discussed above.

Thus, the case for discrimination appears rather weak in practice, even in markets where there is imperfect competition. The best (economic) case for discrimination revolves around situations where there is asymmetric information, e.g., difficulties in monitoring the performance of a contractor if buyer and provider are located far from each other, or a need to offer a firm quasi-rents in order to increase the probability of contract compliance through the threat of losing repeat business (Laffont and Tirole 1991). Moreover, geographic proximity may be a precondition for effectively contesting procurement markets—making some products, in particular services, in essence non-tradable. Problems of asymmetric information and contract compliance may imply that entities can economize on monitoring costs by choosing suppliers that are located within their jurisdictions. In turn, this will make it more difficult for foreign firms to successfully bid for contracts, even if the goods or services involved are tradable. Such rationales have been explored extensively by Laffont and Tirole (1993); many of the underlying technical arguments are summarized and synthesized in Breton and Salmon (1995).

6. Implications of these analyses for the impact of international disciplines.

What, then, are the implications of the extant economic literature for the design and efficacy of international disciplines on discrimination and transparency in government procurement? The first point is that, if the goal of an international agreement is to eventually eliminate resource-distorting discrimination in public procurement, then the disciplines on discrimination must go beyond a ban on *de jure* discrimination, such as price preferences. The Uruguay Round GPA's provisions on *de facto* discriminatory measures against foreign firms in regard to their costs, or to their ability to bid for state contracts in the first place, are weaker than those on *de jure* discrimination. This is a concern because price preferences tend to be the least (economically) costly form of procurement discrimination (Deltas and Evenett 1997, McAfee and McMillan 1989). One unfortunate implication of the *status quo* is that it is likely to encourage policymakers that want to circumvent the GPA's disciplines to substitute transparent price preferences for murkier forms of discrimination; so reducing the potential market access and welfare benefits of the GPA.¹³

One reform option might be to tighten up on the *de facto* cost-based and entry-based discrimination, through more stringent rules on transparency of public procurement practices and tougher domestic and international review procedures, and to relax the ban on price preferences. The goal here is to try to channel any protectionist pressures into *observable* price preferences, whose level can then subsequently be negotiated down over time. In addition, one could modify the pre-selection procedures to allow firms that have not pre-qualified to bid to do so, but with a fixed price preference applied against them. Apart from this price preference, the bids of such unqualified firms would be treated identically to those firms who pre-qualified. The advantage of such an approach is that it caps any distortions created by the pre-qualification process.

With respect to bribery and corruption, the research summarised earlier has shown that such malfeasance narrows the circumstances under which measures to eliminate procurement discrimination yields benefits. To the extent that bribes and pay-offs to government officials result in a higher price being paid by taxpayers for a good, then this

¹³ Of course, the GPA is not the only international trade agreement where possibility for substitution between trade policy instruments exists.

reduces the quantity demanded by government. This increases the likelihood that this government demand can in principle be met solely by domestic producers, which means that the subsequent imposition of a procurement ban (or other form of discrimination) against foreign bidders merely redistributes government sales from foreign firms to domestic firms, without the latter's output rising. Domestic consumers' demand shifts from domestic firms to foreign firms at exactly the same rate as government demand is shifting in the opposite direction. Under these circumstances, the net effect of procurement discrimination on imports (market access) is zero. By the same logic, the removal of such discrimination will not increase imports (market access) either. This implies that the benefits of membership of the GPA are contingent on the degree of bribery, corruption, and other governance-related problems in national procurement practices; highlighting the interdependencies between the different aspects of public procurement regimes. It should be said that this research finding does provide an argument against joining the GPA *per se*. Rather it suggests that, so as not to compromise the benefits of joining the GPA, complementary additional measures to improve governance practices will be needed. Of course, whether those additional measures ought to be integrated into a multilateral trade agreement or taken as part of a national initiative (perhaps supported by donors and the international development agencies) is another matter.

We close with the following thoughts. We certainly do not want to leave the reader with the impression that existing research has settled all of the major policy questions in the area of public procurement. There is considerable scope for experts, officials, and others to explore new approaches to public procurement reform in developing countries (and, for that matter, in industrialised countries too.) Since the July 2004 Framework Agreement among WTO members effectively ended the prospect of negotiations in transparency in government procurement for the duration of the Doha Round, there is now a substantial opportunity for trade diplomats, procurement officials, and non-governmental experts and bodies to explore the efficacy of different types of national and international initiatives on procurement matters. For example, experimentation at the regional and bilateral level continues apace, and the question arises as to whether any of the initiatives could or should be "scaled up" to the global

level.¹⁴ Further attention could also be given to the linkages between procurement policy and other government policies, such as industrial policy, competition law, and policies towards small and medium sized enterprises. It is not clear that all of the implications of national and international reform efforts for these linkages have been thoroughly established. It would also be useful to better gauge how effective the non-binding UNCITRAL¹⁵ agreement has been in fostering procurement reforms. These and other matters¹⁶ are worthy of careful examination over the coming years in a climate that will hopefully be less fevered than in the recent past.

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¹⁴ For an earlier comparison of the government procurement provisions of bilateral and regional agreements see OECD (2002).

¹⁵ Specifically, we mean the UNCITRAL Model Law on Procurement of Goods, Construction, and Services with Guide to Enactment.

¹⁶ For a more extensive account of the questions and matters that might be fruitfully addressed in the coming years, see Evenett and Hoekman (2004b).

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