

PART FOUR

*Government procurement
and State trading*

CHAPTER 18

Government procurement

Summary

The rules of GATT specifically exempt purchases made by governments and the agencies controlled by them from the national treatment rule. Government agencies importing their requirements are also not obliged to extend MFN treatment to external suppliers of such products but only to give them fair and equitable treatment. These provisions permit purchasing agencies to buy their requirements, if they so wish, from domestic producers, even though products of comparable quality are offered for sale by foreign suppliers at lower prices.

The Agreement on Government Procurement, which was extensively revised in the Uruguay Round, requires its member countries to accord national and MFN treatment to government purchases. The obligation to extend such treatment applies to purchases made by the government agencies listed by each member country in the annexes to the Agreement. These annexes form an integral part of the Agreement. The Agreement further requires the listed agencies to make their purchases by inviting tenders, in which foreign suppliers should have a fair and equitable opportunity to participate.

The new Agreement on Government Procurement is, however, plurilateral and, unlike the multilateral Agreements described in the preceding chapters of this Guide, WTO member countries are not obliged to join it. The Agreement's current members are predominantly developed countries. Only three developing countries/areas – Hong Kong (China), the Republic of Korea and Singapore – have so far acceded to it. Developing countries that are not members are not bound by the obligation it imposes to extend MFN and national treatment to foreign products and suppliers.

It is important to note, that in order to prepare developing countries to accede to the Agreement, work is currently being carried out to develop an interim agreement on transparency in government procurement. The agreement, which will be multilateral in character, will not impose obligations on member countries to extend MFN and national treatment. It will only carry procedural provisions leading to improved transparency in the methods adopted by government purchasing agencies for procuring goods. (See chapter 11.)

In almost all countries, governments and the agencies controlled by them are significant buyers of goods and services. Such purchases often represent 10% to 15% of a country's gross national product. The international trade in government-purchased products and services is steadily on the increase and currently amounts to several billion dollars annually.

Historical background to the evolution of rules

The international rules governing this trade are evolving. When GATT 1947 was being negotiated, almost all countries required their government departments and agencies to accord price preferences to domestic producers and to buy foreign goods only if the domestic prices were higher (by, say, 10% to 15%) than the prices of imported products. In addition, where goods were imported, purchasing agencies were often obliged to buy from suppliers in countries with which their governments had close trade relations or political ties.

The practice of giving price preferences was not consistent with the national treatment principle which, as has been noted, does not permit imported products to be treated less favourably than products of domestic origin. Likewise, obliging purchasing agencies to obtain their imports only from a limited number of designated countries was not in conformity with the principle of non-discrimination embodied in the MFN rule.

GATT 1994, Article III:8(a)

As countries were not prepared at that time to change these practices, the GATT rules specifically exclude procurement by government agencies of goods for their own use and not intended for commercial sale from the application of the national treatment rule. The rules also do not require countries to extend MFN treatment to sources of products imported by government agencies for their own use. They are merely asked to extend fair and equitable treatment to such suppliers.

GATT 1994, Article XVII:2

Agreement on Government Procurement

Policies which require government purchasing agencies to buy locally, even though foreign goods are available at lower prices, increase government expenditure and add to the burden on tax payers. These considerations, among others, led GATT member countries to negotiate in the Tokyo Round an Agreement on Government Procurement. This Agreement, which applied only to goods, was extensively revised and broadened to cover purchases by governments of services during the parallel negotiations that took place during the Uruguay Round.

Aim

Agreement on Government Procurement, Preamble

The main aim of the Agreement on Government Procurement is to require governments to apply commercial considerations when procuring goods and services for their own use by not discriminating between domestic and foreign supplies and thus to utilize tax revenues and other public funds more effectively. It is, however, a plurilateral agreement and, unlike the multilateral Agreements discussed earlier, does not oblige WTO members to accede to it. Its current membership is dominated by developed countries, with only three developing countries/areas – Hong Kong (China), the Republic of Korea and Singapore – on the roster.

Coverage

Agreement on Government Procurement, Article I and Appendix I

The obligations which the Agreement imposes apply only to purchases made by the procurement entities that have been listed by each member country in its annexes. These annexes are an integral part of the Agreement. The entities listed include:

- Ministries, departments and other central government offices;
- Sub-central organizations such as municipalities, corporations and other local bodies;
- In the case of federal States, government departments and agencies at provincial and State level;
- Public utilities supplying electricity and drinking water, and running airports, ports and urban transport.

It is open to member countries to specify in the annexes the products and services to be covered by the Agreement. In regard to goods, member countries have broadly indicated that the Agreement will apply to all purchases by the listed entities. The only exceptions are purchases by departments of defence of defence requirements; purchases made by such departments of non-defence requirements are, however, covered.

While the Agreement therefore applies to almost all contracts awarded by the government agencies concerned for the procurement of goods, only a beginning has been made in relation to purchases of services. All member countries have included construction services in the Agreement's coverage. Thus this service segment, on which governments spend a high proportion of their budgetary resources, has come under the Agreement's discipline. As regards other services, the rules of the Agreement apply only to those specified in each member country's annex. Among these are:

- Management consultancy and related services;
- Market research services;
- Computer and related services;
- Accounting and auditing services;
- Advertising services;
- Building cleaning services; and
- Publishing and printing services.

Substantive provisions

Agreement on Government Procurement, Article III

The Agreement's most important obligation requires purchasing entities to extend to imported products, services and suppliers national and MFN treatment. The first prevents them from giving price or other preferences to domestic suppliers; the second prohibits them from discriminating among outside supplying countries.

Operational provisions

Agreement on Government Procurement, Articles VII to XVI

In order to ensure the implementation of these substantive obligations and to provide fair and equitable opportunities for trade to interested domestic and foreign suppliers, the Agreement lays down a number of procedural rules. In particular, it requires entities making purchases above specified threshold limits:

- To do so only by inviting tenders;
- To ensure that foreign suppliers have a fair and equitable opportunity to participate in the tendering process; and
- To award the contract to the tenderer who has been determined to be fully capable of undertaking the contract and whose tender "is either the lowest tender or which in terms of the specific evaluation criteria set forth in the notice is determined to be most advantageous".

Box 44 explains the various methods that can be used in inviting tenders and the conditions for their use.

Box 44**Rules on government tendering procedures**

The Agreement requires that, in order to provide fair and equal commercial opportunities to domestic and foreign suppliers and at the same time ensure efficient and expedient procurement, government purchasing entities should make their purchases by inviting tenders. These entities have an option to use one of the following three methods:

- Open tenders, under which all interested suppliers may submit a tender;*
- Selective tendering procedures, under which only suppliers who have been identified as having the necessary qualifications are invited to tender; and*
- Limited tendering procedures, under which in certain special circumstances purchases are made through direct negotiations with identified suppliers.*

For tenders under selective procedures, enterprises generally maintain a list of qualified suppliers. The Agreement stipulates that in qualifying suppliers, the purchasing entities:

- Should not discriminate between foreign and domestic suppliers;*
- Should impose only such conditions in regard to technical qualifications, financial guarantees, and establishing the commercial capability of suppliers as are necessary to ensure the firm's competence to fulfil the contract; and*
- Should allow suppliers to apply at any time for qualification.*

The Agreement provides that limited tendering systems should be used only in special situations such as:

- When no tenders are received in response to an open and selective tender;*
- When the tenders submitted have been collusive;*
- When additional deliveries of replacement parts are required from a supplier whose tender has been accepted.*

Further, in order to ensure adequate transparency in the invitations to tender, the Agreement requires member countries to notify WTO of the list of publications in which invitations to tender are publicized.

Greater public scrutiny of award decisions

In the area of government procurement, it is not uncommon to hear complaints that contracts involving huge amounts have been awarded to a tenderer with the right political connections. Allegations are also often heard that contracts have been awarded to domestic or foreign firms that have made clandestine payments to the persons responsible for making award decisions. The Agreement visualizes bringing such malpractices under control by providing for greater public scrutiny of decisions to award contracts. It therefore requires purchasing entities to publish:

- A post-award notice stating the nature and quantity of the product or services covered by the contract;*
- The name and address of the winning tenderer;*
- The value of the winning award; and*
- The highest or lowest offer that was taken into account in the award of the contract.*

In addition, if an unsuccessful bidder requests it, the purchasing entity is required to give the bidder its reasons for both the rejection and the selection.

Challenge procedures

Agreement on Government Procurement, Article XX

The Agreement also calls on its member countries to establish at the national level an independent review body to hear challenges or complaints and requests for redress from domestic or foreign suppliers against a purchasing entity which in their view has not adhered to the rules of the Agreement in awarding a contract. The procedure for investigating such challenges should, *inter alia*, provide for:

- Interim measures to correct breaches of the Agreement's rules, including measures which may result in the suspension of the procurement process, or
- Payment of compensation to the challenging tenderer, which may be limited to the costs of preparing the tender or the challenge.

In addition, when the government of the country where the foreign supplier is situated is satisfied that the rules of the Agreement have not been followed by the entity in awarding the contract, it can invoke WTO dispute settlement procedures.

Agreement on Government Procurement, Article V

Special provisions for developing countries

As noted earlier, only three developing countries/areas have so far acceded to the Agreement. The reasons for the reluctance of developing countries to join the Agreement can generally be attributed to the apprehension that, on becoming a member, they will have to change their existing policies. These policies currently require their purchasing agencies to buy locally whenever possible and, when they are allowed to invite tenders from foreign suppliers, to give price preferences to domestic producers. Further, in order to promote the development of SMEs, domestic rules often oblige purchasing agencies to prefer SME products to those of large firms.

Agreement on Government Procurement, Article V:5

However, the Agreement does provide for special and differential treatment. This permits developing countries to negotiate for accession without being obliged to bring all their practices in conformity with the Agreement immediately on joining. They can stipulate, for instance, that the discipline of the Agreement should apply only to a specified number of purchasing agencies. Furthermore, they can negotiate for "exclusions from the rules on national treatment" certain products or services for which they wish to continue to extend price preferences to domestic producers by buying from them even though the prices quoted by foreign suppliers are lower.

Agreement on Government Procurement, Article V:12 - 13

The Agreement has specific provisions on special treatment to be accorded to least developed countries with respect to products or services originating from them. It imposes an obligation on developed countries to provide assistance, on request, to potential tenderers in these countries in submitting tenders, and in complying with technical regulations and standards relating to products or services subject to an intended procurement.

Agreement on Government Procurement, Article V:11

Furthermore, to enable suppliers in developing countries that have become members of the Agreement to benefit fully from the opening of the government procurement market, each developed country is required to establish information centres from which information can be obtained on:

- Laws, regulations and practices relating to government procurement;
- Addresses of entities covered by the Agreement;
- Nature and volume of products or services procured, including available information on future tenders.

From the strictly legal point of view, requests for such information can be made only by members of the Agreement. In practice however most, if not all, of these

information centres may be willing to provide information to developing country members of WTO even though they may not have acceded to the Agreement itself. The Agreement further visualizes the establishment at an appropriate time in the future of an international information centre. As such a centre will provide information and assistance to interested suppliers in developing countries, the chances of its being set up will depend greatly on how many developing countries accede to the Agreement in the near future.

Negotiations for improvements in the Agreement

Agreement on Government
Procurement, Article
XXIV:7

The Agreement calls on member countries to undertake further negotiations, within a period of three years from its entry into force (1 January 1996) and periodically thereafter, to improve the Agreement. In pursuance of these provisions, the Committee on Government Procurement initiated in February 1997 negotiations covering following elements:

- ❑ Simplification and improvement of the Agreement, including, where appropriate, adaptation to advances in information technology;
- ❑ Elimination of discriminatory measures and practices that distort open procurement;
- ❑ Expansion of the product coverage of the Agreement; and
- ❑ Broadening membership of the Agreement.

The participating countries are planning on completing the negotiations at least on the first item (simplification and improvement of the Agreement) in 1999, well in advance of the Third Ministerial Conference.

Interim agreement on government procurement

As noted earlier, only three developing countries/areas have become members of the Agreement. One reason for this is the developing countries' apprehension that the Agreement's imposition of the MFN and national treatment principles will require them to do away with their existing practices, under which domestic suppliers benefit from price preferences. In order to encourage developing countries to prepare themselves for acceding to the Agreement, the 1996 Singapore Ministerial Conference decided to establish a Working Group on Transparency in Government Procurement to examine the desirability of negotiating in WTO an interim agreement on transparency in government procurement. The interim agreement, unlike the Agreement on Government Procurement, is to be a multilateral agreement binding on all member countries. It will, however, not impose substantive obligations for the extension of MFN and national treatment but will set out such procedural provisions as will result in greater transparency in the methods used by government purchasing agencies in procuring goods. Chapter 24 presents an overview of the discussions that are currently taking place in the Working Group.

Work on government procurement under the provisions of GATS

GATS, Article XIII:2

Article XIII:2 of GATS calls for multilateral negotiations on government procurement in services within two years from the date of entry into force of the WTO Agreement. In pursuance of this provision, a Working Party on GATS

Rules has been established by the Council for Trade in Services to undertake preparatory work for negotiations in the area of government procurement. (The Working Party is also responsible for the development of rules on emergency safeguard measures and subsidies.)

Business implications

A number of products purchased by government agencies in developed countries can be supplied by enterprises in developing countries. An indicative list of such products is given in box 45.

At present, suppliers from developing countries are not able to put in bids as they have no access to notices of tenders from purchasing agencies in developed countries. The adoption of electronic systems by purchasing agencies for the issue of tenders will make this information available on the Internet. This will greatly improve the access of business enterprises, particularly in developing countries that have been able to develop Internet facilities, to the government procurement market in other countries. There is also vast potential for regional trade development in the procurement sector among developing countries.

Box 45

Products purchased by government agencies that can be supplied by enterprises in developing countries

Textiles and clothing

Footwear

Office machines and data-processing equipment

Office furniture

Telecommunications equipment

Pharmaceuticals

Medical equipment

Food and food products

Sanitary, heating and lighting fittings

Motor vehicles

Electrical machinery

Paper, printing and publishing products

Rubber and plastic products

Cleaning materials and equipment