PART FOUR

GOVERNMENT PROCUREMENT AND STATE TRADING

CHAPTER 15

Government procurement

Summary of the main rules

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 that was negotiated in the Tokyo Round required its member countries to accord national and MFN treatment to government purchases. The obligation to extend such treatment applied to purchases made by the government agencies listed by each member country in the annexes to the Agreement. These annexes formed an integral part of the Agreement. The Agreement further required the listed agencies to make their purchases by inviting tenders, in which foreign suppliers should have a fair and equitable opportunity to participate.

The Tokyo Round Agreement, which applied to trade in goods, was extensively revised and broadened in the Uruguay Round to cover government purchases of services.

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 two developing countries/areas — Hong Kong and the Republic of Korea — have so far acceded to it.

1. General

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.

2. 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.

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 com-

GATT 1994, Article III, 8(a)

mercial 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

3. The 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.

3.1 Aim of the Agreement

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 two developing countries/areas — Hong Kong and the Republic of Korea — on the roster.

Agreement on Government Procurement (GP), Preamble

3.2 Coverage of the Agreement

GP, 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;
- Publishing and printing services.

3.3 Substantive provisions

GP, 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.

3.4 Operational provisions

GP, 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 34 explains the various methods that can be used in inviting tenders and the conditions for their use.

3.5 Greater public scrutiny of award decisions

GP, Article XVIII

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.

Box 34

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.

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.

3.6 Challenge procedures

GP, 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.

3.7 Special provisions for developing countries

GP, Article V

As noted earlier, only two 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.

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 "exclusion from the rule of 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.

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.

4. Business implications

For industries and business enterprises in developing countries, government procurement provides a huge and growing market. The purchases of government agencies cover a wide range of products that are at present being exported by a number of developing countries (see box 35). With some organizational effort and assistance from governments and international agencies on how to comply with the tendering procedures of foreign purchasing agencies, it should be possible for suppliers from developing countries to compete in this important market segment. It is important to note that member countries of the Agreement on Government Procurement do not prevent suppliers from countries that are not members to tender against invitations issued by their purchasing agencies. The only country making an exception to this rule is the United States. It prohibits its purchasing agencies from buying from non-member countries (other than those that are least developed).

Suppliers from developing countries are often handicapped by their inability to obtain information on invitations to tender issued by purchasing agencies in foreign markets. They may find of some

Box 35

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

help the list given in appendix V of the publications in which such notices are posted by member countries of the Agreement. In addition, it may be possible for them to obtain additional information on the laws and regulations applicable to such purchases from the information centres listed in appendix VI.

It will be in the interest of individual countries that are not members of the Agreement to require government purchasing agencies to adopt procedures for inviting tenders and awarding contracts that are similar to those laid down by the Agreement. For governments, this can lead to reductions in costs and budgetary expenditures. For industry and business, it will provide an assurance that contracts will be awarded on the basis of criteria that are fair and objective.

The basic aim in adopting such procedures should be to prepare the country gradually to accede to the Agreement. In the initial years, however, it may not be possible for the government to throw open its entire government procurement market to foreign competition. In that situation, the procedures should provide for the following:

- The decision not to open tendering to foreign participation should be taken on a case-by-case basis; and

- Where foreign participation is permitted, the tendering notice should clearly indicate whether domestic suppliers are to be given a price preference and, if so, the quantum of such preference.

The disclosure of information on price preferences will help foreign suppliers in deciding whether to tender or not. It will also help governmental authorities in assessing the costs and benefits of requiring purchasing agencies to give preference to domestic producers, taking into account the aims and objectives of such a policy.