Competition and transparency in national procurement markets: implications for development and trade

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Contents of this presentation

1. Motivation and national procurement regimes.
2. Effects of reforming national procurement regimes.
3. What is the logic for international collective action on public procurement policy?
4. Implications for trade policymakers.

Motivation and national procurement regimes

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Why should trade experts know about procurement policy?

- National procurement policies have many objectives and some of them result in measures that affect market access.
- Discrimination against foreign firms is thought to be rife in many nation's procurement policies.
  - Procurement policies are one of few tools left to governments to shape national industries.
  - Procurement is sensitive because of links to corruption, governance, and the funding of national political parties.
- Some trade agreements include provisions on public procurement:
  - The wisdom of doing so is debated.
  - Expanding membership of the GPA.

Principles of Good Procurement Policy

- Principles include:

1. Efficiency (“value for money”).
2. Equality of opportunity to compete for state contracts (“non-discrimination”).
3. Transparency (“control corruption” and ensure accountability).
4. Encouraging investments and partnerships (“public-private partnerships, etc).

- What <u>should be</u> done and what <u>is</u> done may be very different.

Additional considerations on procurement policy in developing countries

- Presence of budgetary aid.
- Tied aid: implications for spending patterns.
- HIPIC initiative: commitments made by recipient governments with respect to expenditure policy.
- Resource constraints and implications for implementation of certain procurement policy measures.
- Size of national procurement markets.

The <u>principal</u> instruments of national procurement policy

1. Procedures to identify, specify, and announce goods to be purchased by the state.
2. Procedures to determine which suppliers are eligible to bid for state contracts.
3. Tendering procedures: open, restrictive, and selective.
4. Evaluation and award procedures.
5. Bid-challenge procedures.

The forms of discrimination in national procurement policy

1. Price preferences.

2. Set asides.

3. *De facto* cost discrimination (e.g. asymmetric regulatory enforcement).

4. *De facto* entry requirements (e.g. qualification requirements).

5. Offsets (content requirements).

Lack of transparency creeps in many ways in procurement policy

Measure.	Potential sources of non-transparency.
Announcements.	•No central public journal for announcements. •Imprecise specifications. •No bulk purchases.
Eligibility to bid.	•Imprecise criteria. •Inability to demonstrate track record.
Tendering.	•Unpublished or imprecise procedures for each type of tendering and for choice of tendering.
Evaluation/Award.	•Role of intangible factors. •Variable preferences.
Bid challenge.	•Time for redress. •Uncertain legal standards.

Effects of national procurement reform

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Cost-benefit analysis of improving transparency

- **Costs:** Establishing, operating, and enforcing clear rules requires resources.
- **Benefit 1:** Improving transparency reduces uncertainty for potential bidders (both domestic and foreign) that encourages them to compete for government contracts and lowers prices paid by state.
  - Research shows SMEs are especially responsive to reductions in uncertainty.
- **Benefit 2:** Clearer procedures mean that firms need to spend less time and money being sure they have complied with specified bidding requirements. So, existing bidders have lower costs.

Importance of competitive tendering

- A strong finding of research on public procurement practices is that increasing the number of bidders substantially reduces the price paid by the state—especially when initially 5 or fewer firms bid.
- If value for money is the objective, then the participation of the largest number of qualified bidders should be encouraged.
- Open competitive bidding places no *a priori* restrictions on who can bid—unlike other tendering processes.

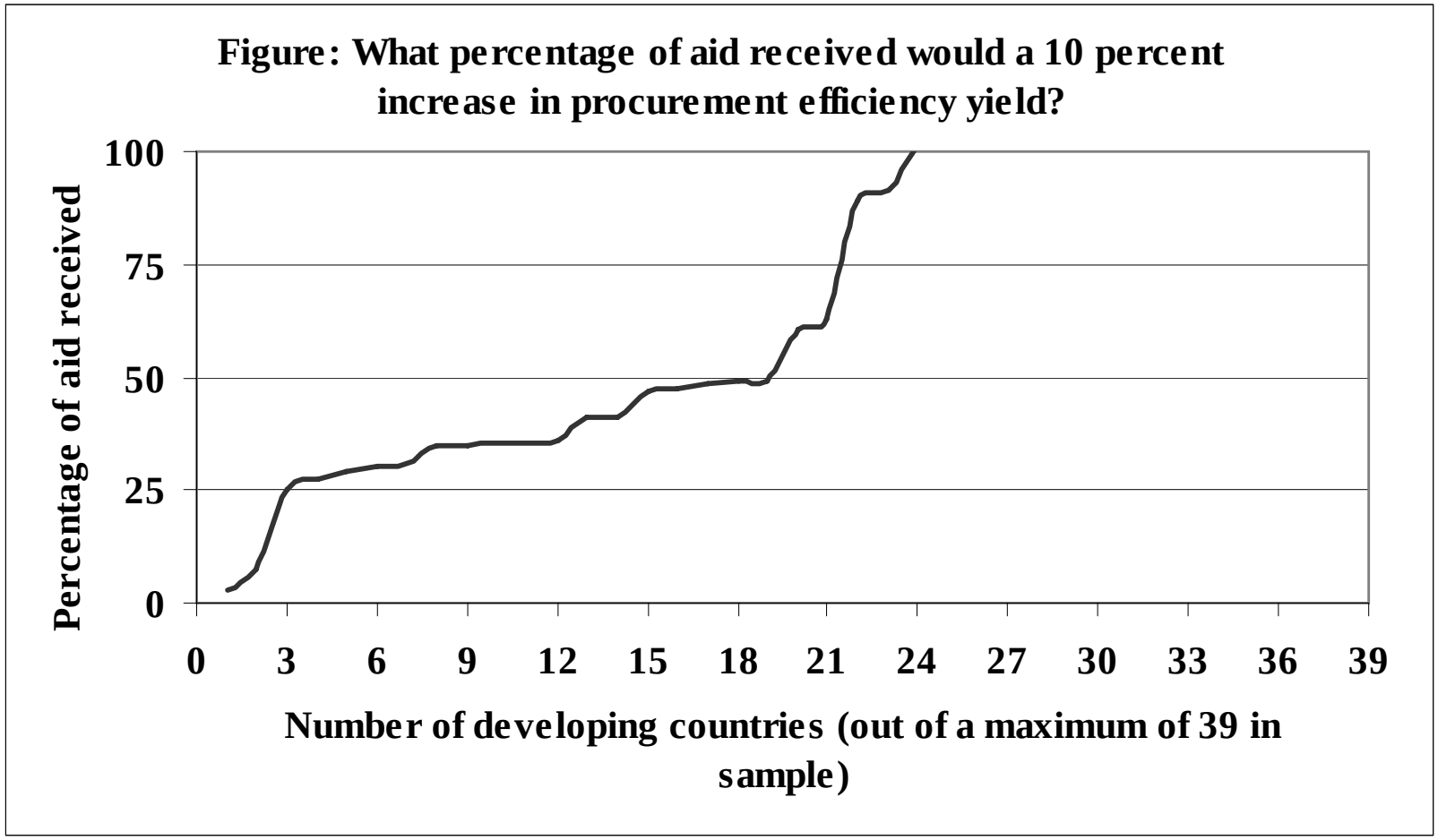
Comparing price preferences to other forms of discriminatory measures

- Governments use measures other than price preferences to discriminate against foreign firms including:
  - import content restrictions/domestic content requirements.
  - stronger de facto regulation of national regulations for foreign firms.
  - restrictions on ability to bid through a variety of selective or limited tendering procedures.
- First two of the above measures raises the costs of the foreign firm or bidder; last measure affects their ability to contest the auction in the first place.
- Simulations suggest the following ranking of policy measures in terms of increasing effects on expected costs: price preferences, cost increasing measures/discrimination, and selected or limited tendering.

Cost over-runs

- Occur when the actual cost of a project's implementation exceed its contracted or planned cost.
  - Much energy is spent by procurement officials to avoid this outcome, still…
- If cost over-runs by domestic firms are more likely to be bailed out by the domestic government, then domestic firms are provided with an incentive to lower their bids when seeking the state contract.
- Problem arises because a government may not be able to commit to a symmetric policy towards bail-outs, including potentially a policy of no bail-outs.
- See Mattoo (1997) for further discussion.

Small improvements in procurement policy would have large aid-equivalent payoffs



What is the logic for international collective action on procurement policy?

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Rationale for international collective action

- Market access-based arguments: traditional reciprocity.
- Why international collective action on transparency in procurement practices?
  - Recall such reform may cause more of domestic and foreign firms to bid.
  - Domestic exporters may support these measures if other barriers do not entirely block their access to foreign markets.
    - Need to combine transparency reform with market access measures: to preserve the “original bargain”.
  - Points to the value of combining transparency and market access provisions in a multilateral initiative.

Implications for trade policymakers

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Implications for policymaking

- National procurement regimes comprise many state measures that can deliberately or otherwise disadvantage potential foreign bidders for state contracts.
- Generally, measures that facilitate a greater number of bidders for state contracts result in greater value for money, especially when the initial number of bidders is low.
- The multi-faceted nature of procurement regimes typically means that there is a greater payoff from packages of reforms than from individual reform measures.
  - Reflects the potential substitutability between state procurement instruments.
  - Packages of reforms can be built into trade agreements.