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Government procurement: market access, transparency, and multilateral trade rules

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Abstract

This paper examines the effects on national welfare and market access of two public procurement practices, discrimination and nontransparency. Both policies have become prominent in international trade negotiations, including the Doha Round of World Trade Organization (WTO) trade talks. We show that fostering either domestic competition or transparency in state contracting tends to improve welfare. In contrast, we find no clear-cut effect on market access of ending discrimination or improving transparency. This mismatch between market access and welfare effects may account for the slower progress in negotiating procurement disciplines in trade agreements than for traditional border measures such as tariffs.

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1. Introduction

With the conclusion of the Uruguay Round and the creation of the World Trade Organization (WTO), multilateral disciplines applying to all WTO members were established in many areas. One substantial exception is in government procurement, where the principles of nondiscrimination have only been accepted on a voluntary, plurilateral basis. Developing countries have been subject to substantial pressure to agree

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to multilateral disciplines limiting their ability to discriminate in favor of domestic firms when allocating state contracts. Their vigorous resistance to such pressure led a number of WTO members in the late 1990s to propose that multilateral efforts be confined to attaining agreement on improving transparency in this area.[1] At the December 1996 WTO Ministerial meeting in Singapore, it was agreed to establish a Working Group with the mandate to study transparency in government procurement practices and develop "elements for inclusion in an appropriate agreement" (WTO, 1996, p. 6).[2] Having said that, at this time, members of the WTO have yet to agree whether, when and on what terms negotiations on this subject will begin.

Given that the WTO is a forum to negotiate and enforce commitments to improve access to national markets, one important motivation for pursuing transparency in this forum is to enhance the capacity of foreign suppliers to contest procurement markets. In this paper, we investigate the extent to which improving transparency enhances market access. We also examine the likely impact on national welfare of alternative multilateral disciplines on government procurement policies, allowing an assessment of whether reforms that enhance welfare also improve market access, and visa versa. This two-part evaluation is important, as traditionally, the formula for successful trade reform under the WTO umbrella has involved initiatives that enhance national welfare through improving market access.[3]

Although our analysis is largely motivated by developments at the WTO, the findings also apply to regional efforts to agree on common rules for procurement practices. Procurement disciplines are, for example, on the agenda of the Free Trade Area of the Americas (FTAA) initiative, and will also figure in future efforts to expand the coverage of Euro–Mediterranean Partnership Agreements. More generally, the analysis developed here can be applied to situations where one group of potential purchasers decides to discriminate against a class of sellers on the basis of an observable characteristic that is not directly related to the product itself, such as location of the production facility of a seller. As such, our analysis may shed light on the effects of consumer and investor boycotts and not just the behavior of state-procuring entities.

Like others, we analyze the impact of state procurement discrimination against foreign firms in a partial equilibrium setting with perfect competition. Unlike earlier studies, however, we are not only interested in the short-run consequences of such discrimination but in the long-run effects also. This enables us to examine whether the effects of procurement discrimination are sensitive to the ease of firm entry and exit which, in turn,

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[1] The United States has played a leading role in this connection. U.S. legislation requires the United States Trade Representative (USTR) to monitor foreign procurement policies that deny access to markets for American goods and services, and procurement policies figure prominently in USTR's annual *Foreign Trade Barriers Report*. The Clinton Administration made public procurement a priority trade policy issue, linking this to the broader issue of corruption. "This Administration is determined to...push initiatives to clean up government procurement practices around the world" (*Financial Times*, May 1, 1995, p. 5). In April 1996, largely at the insistence of the US, OECD members agreed not to allow firms to write off bribes against tax obligations (*Oxford Analytica*, April 18, 1996).

[2] For an analysis of the origins of this Working Group, and its relationship to the Uruguay Round Agreement on Government Procurement (GPA), and the likely consequences of strengthening transparency provisions in the GPA, see Arrowsmith (1997).

[3] As is the case in the small open economy that lowers import tariffs as part of a multilateral trade agreement.