

# Emerging Disciplines on Government Procurement in Trade Agreements

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The Commonwealth



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## Summary

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- *Government Procurement is an opaque activity globally - it is noted as a challenging regulatory area, which in decades of voluntary and formal agreement has led to limited changes in governments' purchasing practices.*
  - *Multilaterally, government procurement is addressed under a Plurilateral agreement within the WTO. Signed in 1996, the Government Procurement Agreement (GPA) has only 17 parties comprising 45 WTO members, 3 of which are Commonwealth countries.*
  - *Government procurement accounts for a large share of economic activity in all Commonwealth countries. Typically, developed countries government procurement amounts to 15-20% of GDP (Lamy 2009, Anderson et al 2011). In developing countries and emerging economies this figure often exceeds 30-40%.*
  - *To date 43 PTAs include explicit government procurement rules, over half of these came into force since 2000.*
  - *PTAs, which include explicit government procurement rules typically, ban a range of other policy instruments, which favour domestic firms, such as local-content requirements.*
  - *The Trans-Pacific Partnership (TPP) is the first international trade instrument to comprehensively address government procurement and attempts to restrict governments hitherto predilection towards local (domestic) procurement.*
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## Context

Mega regional trading arrangements are on the ascent. The last couple of decades have seen a significant increase in the range and scale of regional trading arrangements, to the extent that Bhagwati et al (1998) described this proliferation as a 'spaghetti bowl of trading arrangements.' Mega regionals have an expansive rule making agenda, typically described as GSP+. They are perceived as a pathway to larger Free Trade Areas of the future - such as a Free Trade Area of the Pacific (FTAP). Of particular interest are the

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recently signed Trans-Pacific Partnership Agreement (TPP<sup>2</sup>) and the Regional Comprehensive Economic Partnership (RCEP). The pre-eminent Transatlantic Trade and Investment Partnership (TTIP), which will link the EU and North America (including Mexico), is also of emerging significance. New issues in international trade agreements, including mega-regionals are increasingly focused on less transparent policies; such as government procurement, competition policy, investment policies, SOEs and technical barriers to trade.

The rules being set under these agreements have far reaching implications for countries which are not members, but are greatly impacted on, as a consequence of foreseeable changes/diversions in trade and investment flows, as countries party to the agreements converge, whilst those on the fringes may see their competitiveness eroded in key sectors.

This brief focuses on the government procurement chapter under the TPP and highlights elements of other chapters that have linkages to procurement. We note the opacity of government procurement and the consequent challenge of detecting treaty violations, particularly given no *specific* tool is defined for member countries to centrally report covered government contracts awarded within the TPP.

## TPP Headline Issues - Upside:

- Parties agree to the core commitment of national treatment and non-discrimination.
- Parties' commitment to transparency in government procurement, rules and procedures will benefit domestic and foreign companies; reducing risks of bidding, increasing competition and lowering prices paid by government.
- Timely, electronic advertising of tender requirements to enable bidders' time to obtain tender documentation and submit a bid.
- Parties agree to fair and objective use of technical specifications to award contracts based on the evaluation criteria specified in the tender documentation.
- Parties agree to a positive list of entities and activities that are covered in the agreement.
- A harmonised set of rules of origin that clearly defines whether a good is 'originating' and therefore eligible for preferential tariff benefits under the TPP
- TPP wide system of verification of goods produced in the TPP meet the Rules of Origin
- Allowance for accumulation, that is, how much of a product must be made within the TPP in order to qualify for duty-free status. Captured in the Rules of Origin Chapter 3, Article 3.10. This provision takes into account the pre-eminence of global value chains. However, this has concomitant downside elements for non-TPP member developing countries.

## TPP Headline Issues - Downside:

- Generally non-participating countries can be split into two groups; one group will experience mixed outcomes, whilst the other group may generally experience

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<sup>2</sup> Members are: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam and the United States.

negative effects<sup>3</sup>, particularly developing countries and LDCs. For example, Narayanan and Sharma (2014) estimate mixed outcome for India, whilst Thorstensen and Ferraz (2014) calculate an overall negative impact on Brazil.<sup>4</sup>

- Cutting domestic costs within the TPP countries, through a focus on cutting labour share of income (primarily in order to increase profitability and retain investors, wage bills may be cut), which will result in an effective devaluation, i.e., a drop in the real exchange rate. Thus increasing the competitiveness of TPP country goods and services. This would augment TPP country companies' ability to undercut prices of firms from non-TPP countries, given their increased competitiveness, including in procurement bidding processes. Aside from the real devaluation, there is also a concern for example that Vietnam's anticipated increased competitiveness will have a significantly negative impact for Sub-Saharan Africa developing countries with respect to garment and textiles in the US market, through an erosion of AGOA.
- The cost of achieving TPP procurement compliance may be considerable<sup>5</sup>.
- At the Doha Ministerial Conference (2001) ministers recognised an issue of concern to developing countries, that '*negotiations shall be limited to the transparency aspects and therefore will not restrict the scope for countries to give preferences to domestic supplies and suppliers.*'<sup>6</sup> Subsequently issues of transparency in government and other new issues were judged as beyond the Doha work programme. TPP explicit rules on transparency and preferences to domestic suppliers will undoubtedly shape future negotiations on these issues in the WTO.

## An Overview: Government Procurement

Lending from the TPP - '*government procurement* is the process by which a government obtains the uses of or acquires goods or services, or any combination thereof, for governmental purposes and not with a view to commercial sale or resale or use in the production or supply of goods or services for commercial sale or resale.'

The WTO passed the Agreement on Government Procurement (GPA) in 1996. This is a plurilateral treaty in which countries voluntarily agree to abide by set codes/regulations in government procurement practices. The intention being to secure transparency and open competition for domestic and foreign firms. It is noted that the GPA does not cover all government procurement. Currently the GPA has 17 signatory<sup>7</sup> and 30 observer<sup>8</sup> countries.

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<sup>3</sup> World Bank (2016), Global Economic Prospects, World Bank Group, Washington, DC.

<sup>4</sup> Noted in Capaldo, J., Izurieta, A., and Sundaram, K., (Jan 2016) 'Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement. Global Development and Environment Institute, Working Paper No. 16-01

<sup>5</sup> Finger and Schuler (2001) estimate the implementation cost of some WTO agreements at USD 150 million for each country. 'Implementing the Uruguay Round Agreements: Problems for Developing Countries.' The world Economy 24 (9)

<sup>6</sup> As noted in the Doha Ministerial Declaration [https://www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_dda\\_e.htm](https://www.wto.org/english/tratop_e/gproc_e/gp_dda_e.htm) (accessed 16 February 2016)

<sup>7</sup> Signatories to the GPA: Armenia, Canada, European Union (28 member states), Hong Kong (China), Iceland, Israel, Japan, Republic of Korea, Liechtenstein, Montenegro, Aruba (Netherlands), New Zealand, Norway, Singapore, Switzerland, Chinese Taipei, United States.

<sup>8</sup> Observers to the GPA: Albania\*, Argentina, Australia\*, Bahrain, Cameroon, Chile, China\*, Colombia, Costa Rica, Georgia\*, India, Indonesia, Jordan\*, Kyrgyz Republic\*, Malaysia, Moldova\*, Mongolia, Oman\*, Panama, Pakistan, Russian Federation, Saudi Arabia, Seychelles, Sri Lanka, Tajikistan\*, Thailand, Macedonia, Turkey, Ukraine\*, Viet Nam. \* *Negotiating accession*

In 2011 the parties to the GPA reached an agreement on an updated set of procurement rules. However, progress in further developing rules with respect to exclusions, standards and concerns of national security etc. has not picked up pace, neither has the GPA been able to attract new intake of observers/members.

The TPP is the first agreement to set out rules for government procurement, to which all members of the partnership must adhere although transitional measures (adjustment) is provided for. The rules for government procurement under the TPP align aspects of government procurement broadly with rules for competition policy (chapter 16), see Commonwealth Secretariat brief on CP.

An increasing prominent non-tariff barrier is discrimination in government procurement. This affects all countries in various measures. Governments may frequently, wittingly or unwittingly, discriminate against foreign suppliers in favour of domestic ones when purchasing goods and services. Including a procurement chapter in mega regional agreements provides an opportunity for governing bodies (and indeed governments) to scrutinise members' procurement practices. For those countries, which have a particularly opaque government procurement framework, providing an updated system for government procurement practice will be advantageous for a broad range of domestic stakeholders as well.

The objective is to define a level-playing field in which domestic and foreign firms face the same regulatory framework (and incentives) in competing for government contracts. The presumption is that a well-defined government procurement agreement will reduce government's propensity to 'buy national.' Yet a challenge remains in regulating this relatively opaque policy area via international treaties.

A number of countries have committed to higher thresholds for covered procurement for Central Government entities under the agreement. These are Brunei Darussalam, Japan, Malaysia and Viet Nam. Typically the smaller economies of Malaysia and Vietnam have longer transitional measures up to 25 years in construction services with higher value of thresholds SDR 63million and SDR 65million respectfully, but also in goods and services of SDR 1.5 million and SDR 2million respectfully with a transition period typically up to 10 years before equalization with other TPP members. It is worth noting that even as a high income economy Japan has opted for a higher threshold for its architectural, engineering and other technical services of SDR 450,000. *See Table 1 for further breakdown.* The USA has a key set-aside for small or minority-owned business, which includes any form of preference, typically an exclusive right to provide a good or service or any price preference. This volume of procurement to small businesses accounted for \$65.5 billion of federal contracting in 2003<sup>9</sup>. It should be clear that a small firm of the USA may turnover millions of dollars per annum and will receive domestic protection under chapter 15 of the TPP; yet these are the same companies that will compete on a level playing field in the TPP market, and with which developing country SMEs would be required to compete in the US protected market. Clearly, a TPP over-arching definition of what constitutes a small business would be helpful in cementing all members (and non-members) understanding of what size business is being afforded protection.

In order to measure the impact of the TPP on non-TPP countries with respect to government procurement, more analysis needs to be undertaken at the country level and with respect to other Free Trade Agreements. Theoretically, one would expect significant

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<sup>9</sup> Major, C., and Moutray, C., (2004) 'The future of small business in the US Federal Government Marketplace.' *Journal of Public Procurement*, Vol. 4, no.3 p454.

displacement of trade away from firms of non-member countries to suppliers within the TPP area, thus most gains achieved by countries within the TPP will be at the cost of non-TPP countries. There are also considerations of the cost of TPP compliance to developing countries, which will amount to millions of dollars, particularly for the majority which are not members of the GPA.

## Scope/Coverage

Government procurement is defined within chapter 15 of the TPP agreement as procurement:

1. of a good, service or any combination thereof as specified in each party's schedule; and
2. by any contractual means, including purchase; rental or lease, with or without an option to buy; build-operate-transfer contracts and public work concessions contracts.
3. relevant value thresholds are specified in each party's schedule to the government procurement annex. The estimated maximum total value of the procurement over its entire duration dictates whether the procurement is considered 'a covered procurement' under the terms of the agreement.
4. No splitting of procurement into separate procurements, so that the value of each of the constituent parts falls below the threshold rules, in order to avoid the obligations of the agreement.

Government procurement is a common practice throughout the world. In the Commonwealth a number of countries at the state and/or provincial level, use government procurement as a mechanism for inclusive, equitable and sustainable development, e.g. notably South Africa, India, Australia, Canada and Malaysia.

Parties agree to transparency and to promote procedural fairness with respect to for example 'listing and reimbursement of pharmaceutical products or medical devices,' a significant portion of the goods procured by governments under state-subsidised healthcare programmes.

There is significant variation between parties to the agreement, in terms of entities listed at the central and sub-regional levels and in terms of procurement coverage. These differences are captured in the notes to the Sections, within each party's annex of the TPP. The US for example does not include sub-central entities within the TPP, although 25 states are included in its schedule to the GPA. However, with the TPP the door is held open to future negotiation of mutually acceptable concessions and on the inclusion of sub-central entities with aligned thresholds for covered procurement within three years of the agreement.

## Exclusions/Limitations

A 'covered' procurement is specified in two main ways under the agreement. Namely, the value of the procurement contract as defined over a threshold (SDR 130,000 - is standard for most goods and services); and through a list of the entities subject to the agreement, as well as a positive list of goods and services for those sectors considered to be sensitive.

For example, Malaysia's schedule, A:3, specifies a positive list of 99 FSC<sup>10</sup> goods and services for Ministry of Defence procurement. All other Ministry of Defence procurement is excluded. Malaysia's schedule Section A: note 4 (ii) specifies the exclusion of all procurement of the Ministry of Education with respect to 'uniforms, text books, and milk and food programmes for pre-school and school children.'

Throughout the chapter (Article 15.2.3) and the schedules of commitment of parties to the agreement there are further exclusions such as: -

- the acquisition and rental of land, existing buildings or other immovable property (or rights thereon)
- Non-contractual agreements- including cooperative agreements, grants, loans, equity infusions, guarantees, subsidies, fiscal incentives and sponsorship organisation.
- Services related to the sale, redemption and distribution of public debt, including loans and government bonds.
- Foreign aid or international grants, loans or other assistance.
- Public employment contracts.
- Parties may adopt or maintain a measure necessary to protect intellectual property
- Environmental measures necessary to protect human, animal or plant life or health

## Market Access Schedules of Commitments

Thresholds for 'covered' procurement under the agreement in Good, Services and Constructions Services. Members articulated list of entities included under the agreement and notes therein of special considerations are stated in country Annexes to the agreement.

Typical exclusions include motor vehicles procured by any listed entity under country schedules. Exclusions are also listed with accordance with particular regions and/or the sub-central entities therein, e.g., health and welfare services, or transport services.

Other exclusions of note across parties' schedules to the agreement include the energy sector, defence and other security exceptions, nuclear industry, government solicitor, shipping building, exceptions to covered procurement of pharmaceuticals, minting/legal tender, cultural industries etc.

Parties may delineate which specific parties to the agreement may be included or excluded from coverage, until such time that parties negotiate mutually acceptable concessions. Parties may also delineate 'set-asides' from obligations the respective percentage of contract value of particular (strategic or public) goods e.g., pharmaceuticals. These set asides and transitional measures noted in Sections G and J of country annexes are particularly useful to carve-out room to achieve broader policy objectives.

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<sup>10</sup> United States Federal Supply Code (FSC)



**Table 1: Thresholds for covered procurement by entities listed in Country Schedules for Central Government**

Member	Goods	Services	Construction Services
Australia	130,000	130,000	5,000,000
Brunei Darussalam <sup>(2)</sup>	250,000	250,000	5,000,000
Canada	130,000	130,000	5,000,000
Chile	95,000	95,000	5,000,000
Japan ( <i>SDR value</i> )	100,000	100,000 <sup>(3)</sup>	4,500,000 (3,240,904)
Malaysia <sup>(4)</sup>	1,500,000	2,000,000	63,000,000
Mexico ( <i>SDR values</i> )	US\$79,507 (57,261)	US\$79,507 (57,261)	US\$10,335,931 (7,443,947)
New Zealand	130,000	130,000	5,000,000
Peru	95,000	95,000	5,000,000
Singapore	130,000	130,000	5,000,000
United States	130,000	130,000	5,000,000
Viet Nam <sup>(1)</sup>	2,000,000	2,000,000	65,200,000

Currency in SDR unless otherwise stated. 1 SDR: 1 USD = 0.720201 (26 Feb 2016)

#### Table Notes

'Thresholds shall be adjusted in every even-numbered year with each adjustment taking effect on January 1,' after the date of entry into force of the agreement.

(1) From date of entry into force of the agreement for Viet Nam to the end of the fifth year. Sixth to tenth year threshold moves to 1,500,000. Subsequent years have various thresholds. With respect to construction services a transition period of twenty-six years is in place, at which time the threshold equalizes with developed countries.

(2) Adjustment period between first to fifth year, equalizes to developed countries

(3) Except architectural, engineering and other technical services covered in the agreement; thresholds are 450,000

(4) From date of entry into force of the agreement for Malaysia to the end of the fourth year. Between the fifth to seventh year goods threshold moves to 800,000. At eighth year equalizes with developed countries.

(5) Services threshold equalizes to 130,000 SDR at the beginning of tenth year. With respect to construction services a transition period of twenty-five years is in place.

Key observations from the thresholds for covered procurement are that developing economies Viet Nam and Malaysia have significant transition periods in place, over and above that which is currently available under the GPA, of which both countries are observers. Of considerable significance is the *twenty-six* year transition period for covered procurement in construction services, with a starting threshold of SDR 65,2 million for Viet Nam. Transition measures for goods and services, whilst in place, are not significant given the lower level threshold committed to. A starting threshold for covered procurement of goods and services of approximately SDR 2million (USD 1,444,402) is well within reach of small businesses of developed countries party to the TPP. It is also worth noting that services trade (maintenance, transport, professional services etc.) could be a large component of government procurement, particularly at the sub-regional level in many countries; the implications for fast liberalisation could be damaging for the country.

## National Treatment and Non-Discrimination Disciplines

- TPP countries must ensure national treatment of any supplier from a TPP country bidding for a contract under 'covered' procurement.
- Each party shall apply to covered procurement of a good the rules of origin that it applies in the normal course of trade to that good.
- A number of members to the agreement have reserved the right under their schedule of commitments, pursuant to security considerations, to maintain industry capability over the sector.
- The GPA code compels members to report on their procurement activities. Yet only fifty per cent regularly provide statistical submissions. The TPP makes no such undertaking of reporting on procurement activities, however there is a mechanism for the maintenance of records of contracts awarded for up to three years.
- The spirit of the agreement obviates against price discrimination, such as choosing domestic suppliers rather than foreign firms, where bids are identical and the foreign firm offers a lower price.
- Disputes with regards to contract awards may be tabled at an independent Review Authority (at the domestic level) to consider complaints of breaches of the procurement chapter (Article 15.19).
- Transition measures and specific delineation of exclusions within the country annexes have provided countries the opportunity to carve-out exclusions under the agreement. Even at their stage of development, Canada, the USA<sup>11</sup> and Australia have made significant use of country annexes to further policy objectives with respect to disadvantaged domestic communities or regions or small, micro and medium enterprises.

## Technical Specifications

Technical specifications or conformity assessment procedures may not be applied to the tender for the purpose of effecting or creating an unnecessary obstacle to trade between parties.

If prescribing technical specifications, the procuring entity must set out the technical specifications in terms of performance, functional requirements rather than design, quality or descriptive characteristics. This condition makes the case that design and descriptive elements may be highly subjective and open to discretionary evaluation; whilst performance and functionality is readily verifiable through objective assessment.

Additionally, technical specifications must be based on international standards, where they exist; or *at least* national technical regulations, recognised standards or building codes. Thus not subject to arbitrariness. This may be less problematic for existing TPP-countries, but would be challenging for small developing countries that may seek membership in the future or if the TPP becomes (as suspected) a guide for further development of the GPA or other mega-regional agreements.

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<sup>11</sup> Notably, the USA has exclusions on agricultural support programmes; ship building, department of defense procurement, specialty metals - mostly steel production; and nuclear materials.

## Transitional Measures

The TPP agreement makes provisions for developing countries to adopt or maintain a series of transitional measures, with the agreement of the other parties. Transitional periods are set out for a period, allow for a price preference programme, provided that only part of the tender incorporating goods or services originating in that developing country party. The procurement must be transparent, whilst the preference and its application in the procurement must be clearly proscribed in the notice of intended procurement, described as an 'offset.' Developing country parties give a commitment to take steps during the transition period or implementation period that may be necessary to ensure that it is in compliance with the chapter on procurement of the agreement. Each party additionally gives consideration to any request from a developing country for technical cooperation and capacity building in relation to the party's implementation of the procurement chapter of the TPP.

Three out of twelve countries party to the Agreement have transitional measures, namely Brunei, Malaysia and Viet Nam. These measures typically include charges applicable to access notices of intended procurement. Sufficient time allowed for parties to operationalize an e-procurement system and issuance of a legal measure requiring entities to use the electronic system. Parties subject to transition measures may be suspended from the Dispute Settlement discipline for five years, from the date of enforcement of the obligations under the agreement. Ability to request offsets in any form, including a price preference up to a percentage of the annual value of total covered procurement in construction services under the agreement for a period up to the 25<sup>th</sup> year.

## Domestic Policy Implications for Non-Members

- There are consequences for SMEs domestic policy, which may provide preferential treatment to small businesses in a 'set-aside.' Article 15.21 of the agreement recognizes the importance of SMEs to economic growth and employment and the importance of facilitating SMEs access to government procurement. Each party to the agreement is encouraged to consider the cost of tendering, the design and structure of the procurement. The USA Schedule defines a set-aside for small or minority owned business. Australia excludes preferences to SMEs and measures for the economic and social advancement of indigenous people from the agreement. As noted earlier in this brief, protection for small companies in their domestic markets may translate to an opportunity for these firms in the TPP region.
- Further negotiations are posited under Article 15.24 of the agreement. Such negotiations may consider improving market access through a reduction of exclusions and enlargement of procuring entity lists, and a revision of the threshold for covered procurement.
- The sub-regional level of government coverage is not fully defined. Three years after signing the TPP into domestic law parties will engage in further negotiations to determine rules for procurement at the sub-regional level of government.
- Early analysis from a number of sources (World Bank and others) model that the likely impact of the TPP on non-member countries is trade diversion at the cost of developing economies, large and small, notably, India, China, Brazil and Indonesia. LDCs such as Lesotho are also projected to lose significant market share in its key market of the USA.

## Conclusion

Government Procurement has been a significant tool in the policy kit bag of most economies. Developed countries have utilised government procurement to support domestic infant industries, propelling industrial growth, secure technology transfer and innovation, whilst often providing preferences to 'small' or minority/ethnic firms to achieve goals of equitable, sustainable development. It is crucial going forward that developing and particularly least developed countries are able to retain this important development tool.



## The Trade Competitiveness Section

The Trade Competitiveness Section provides technical assistance to Commonwealth member countries in four areas, namely market access; export development; export of services; and trade facilitation, in order to exploit opportunities offered by international trade. The Section works with government ministries, agencies, regulators and their stakeholders to provide assistance to develop their trade competitiveness. Areas of recent intervention include national trade policy formulation, export strategies, aid for trade strategies, competitiveness implications of trade agreements, trade facilitation and gendering trade policy.

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