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## Competition policy and public procurement in developing countries

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# **Competition Policy and Public Procurement in Developing Countries**

**by**

**Rod Falvey, Annamaria La Chimia, Oliver Morrissey and Evios  
Zgovu**

## **Abstract**

Measures to support Competition Policy and enhance the efficiency of Public Procurement can enhance the impact of regional integration agreements. The first part addresses Competition Policy - measures employed by government to ensure a fair competitive market environment. Competition policy aims to ensure that markets remain competitive (through anti-trust or anti-cartel enforcement) or become competitive (through liberalisation). For a variety of reasons, competition is often restricted in developing countries and there are benefits from establishing some level of competition policy. Although the literature does not provide a blueprint, it provides guidance on the most useful ways to incorporate Competition Policy in regional agreements. The second part addresses issues in opening up public procurement and outlines the main potential sources of welfare gains. Open and transparent procurement can bring gains in terms of price reduction, competition and reduced corruption. While developing countries recognize these benefits for domestic policy, they appear opposed to including procurement commitments in international agreements.

**Key Words:** Competition Policy, Public Procurement, Regional Integration

**JEL Classification:** F14, F15, F17

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## 1 Introduction

Developing countries are typically characterized by relatively low levels of competition and limited or no formal competition policy. It is also generally the case that government procurement accounts for a significant share of public spending, and the procedures for awarding and monitoring contracts lack transparency. In this sense there are linkages between weak competition and public procurement, although we treat the two issues separately. Measures to promote and/or regulate competition and to make procurement more transparent offer potential benefits in enhancing the competitiveness and efficiency of the business environment. The aim of this paper is to review the literature to identify what measures may be appropriate for developing countries, in particular for Africa, Caribbean and Pacific (ACP) countries, especially those in sub-Saharan Africa (SSA). We focus on the ACP because these countries are currently strengthening, to varying degrees, their regional integration agreements as they negotiate Economic Partnership Agreements (EPAs) with the EU. These EPAs are intended to replace the Lomé and Cotonou Agreements (see Morrissey and Zgovu, 2007), and one specific aim of this paper is to assess if there is any role for including some commitments towards competition policy and government procurement in the EPAs and/or the regional agreements underpinning them.

Two features of many developing countries render them particularly prone to anti-competitive business practices, in particular abuses of dominant position. The first is that a small, or very small, number of firms tend to dominate many sectors, so *de facto* competition is limited. In part this arises because they are small markets that can only sustain a few large firms; in principle, openness to imports could provide competition, but in practice there is protection (or, for some utilities that have features of natural monopolies, the goods or services are non-traded). In part it may reflect a tradition of State-owned enterprises, which may even be monopolies; while privatization addresses this, it is necessary to ensure that privatization actually introduces competition (rather than a private monopoly replacing a public one). The second is that the institutional framework is weak – the legal contract system and property rights enforcement may be weak, and there is no tradition of competition policy. However, it is precisely because these countries are prone to abuses of dominant position, whether by domestic or foreign firms, that it is important to invest the time and resources required to establish the institutions to address basic competition policy. Although there are no reliable estimates of the cost to an economy of the absence of a competitive environment, there is widely accepted evidence that competition *per se* encourages lower prices and increased efficiency, facilitating a business environment conducive to investment and growth.

There are many policy options that can increase competition in the domestic market – deregulation, trade liberalization and other market opening policies are examples. Competition policy may then be seen as the institutional mechanism that ensures that the newly freed markets remain accessible and contestable, and the Competition Authority (CA) is its organizational counterpart. All these instruments should be seen as complements rather than substitutes (International Competition Network (ICN), 2003). As it is desirable to promote competition, and difficult to keep a close eye on the invisible hand (market mechanisms are less than perfectly transparent and firms have considerable scope and incentives to engage in restrictive business practices), there are potential benefits to be had from establishing some level of competition policy in developing countries. The discussion here concentrates on ACP countries to allow us to consider the potential of including (minimal) commitments for competition policy in regional integration agreements and in related

EPAs; the latter can support the establishment of effective CAs, and this is likely to be beneficial. 'The evidence that competition policy *can* be made to work in developing countries indicates that it can have a positive impact on the institutional environment' (Holmes, 2003, p12). While competition policy can be implemented effectively at the country level, regional cooperation and coordination are important, given trade and foreign investment, and EPAs can support this also. Furthermore, in the context of EPAs, improved trade facilitation (Milner *et al*, 2008) and increased investment (Morrissey, 2008) can increase competitiveness and competition in domestic and regional markets, increasing the need for some competition policy.

Similar issues arise for public procurement, as this is an element of competition in an economy. National, regional and international initiatives aimed at regulating public procurement have increased considerably in recent years. Many developed and developing countries have undertaken reforms of their national procurement systems and have reached agreements opening up their procurement market to international competition, in particular those who have signed up to the Government Procurement Agreement (GPA) in the WTO. These reforms are aimed at ensuring that public funds are used in the most efficient and economic way and that the system delivers value for money, the view being that these can be achieved by promoting transparency, probity and accountability. Some ACP countries have already undertaken reforms of their procurement systems (e.g. South Africa) and others are in the process of reforming them (e.g. Haiti).

As regards the opening up of the procurement market to foreign competition, agreements have been reached at both the regional and international level. These agreements involve mainly developed countries. At the international level the most significant efforts for opening up public procurement have been reached with the GPA, a plurilateral agreement signed within the auspices of the WTO between some WTO Member States, mostly developed countries. However, the GPA does not bind all WTO members but just the signatory country to the agreement (the EU and its Member States are all parties to the GPA). The rationale behind the initiatives aimed at opening up public procurement to international competition is that protectionist measures in public procurement can constitute barriers to trade and competition; they risk disrupting the best allocation of resources worldwide and cause inefficiencies and waste of public resources and taxpayers' money.

This paper begins in Section 2 with a review of issues regarding the desirability of a competition policy, including some problems and concerns, in the light of the incidence of anti-competitive practices in SSA countries (the only ACP countries for which good documentation is available). Section 3 discusses the issues that arise in establishing a competition policy and includes some guidelines on initiating the process. Section 4 provides an overview of the (economic) literature on opening up procurement, given the size of the ACP procurement market, and outlines the main potential sources of welfare gains. Section 5 considers some of the concerns and problematic issues related to agreements on procurement, in particular why developing countries appear opposed to such agreements, with specific reference to EPAs. Section 6 offers some conclusions, arguing that there are potential gains for ACP states in making commitments to competition policy and opening up procurement in regional agreements; EPAs could promote this process, although the issue is inherently controversial. The potential gains are not unconditional and problems are likely to arise in terms of harmonization of rules. Nevertheless, as ACP countries move towards greater regional integration, competition and procurement are issues to be considered in this context.

## 2 Why Competition Policy?

Over the last two decades world economies have become increasingly interlinked in a wave of globalization affecting production and service activities. Interpenetration of national markets through international trade has led to increased competition (from falling transportation and communication costs, more liberal trade regimes and increasing foreign direct investment) in some cases, as well as restricted competition in others (e.g. through use of contingent protection measures, mergers and alliances, misuse of technical barriers to trade including testing and quality controls, labeling rules and certification procedures, discriminatory government procurement, anti-competitive business practices).

Competition policy can be defined as a set of measures employed by government to ensure a fair competitive market environment for all enterprise participants in the market, with competition laws being one among such measures. While trade policy limits the misbehaviour of governments (in the trade arena), competition policy limits misbehaviour by firms, which is even more important when trade (and investment) are liberalized (Jacquemin *et al*, 1998). Competition policy aims to ensure that markets remain competitive (through anti-trust or anti-cartel enforcement) or become competitive (through liberalization). The latter is particularly important in ACP countries where there is often only one or a few major firms in important sectors, so potential abuse of dominant position may be a concern. This is especially relevant for most utilities where network economies of scale imply that many of these markets are natural monopolies (telecommunications is probably an exception given the rising importance of mobile phones, see OECD, 2006). In the context of utilities, regulation may be as important as competition *per se*, and privatization does not in itself address competition issues. However, regulation is an element of competition policy and it remains true that viable competition is desirable, as it tends to be associated with greater efficiency and lower prices, while competitive markets are associated with greater levels of technological innovation and enhanced welfare.

The EU has included competition provision in the bilateral agreements it has entered with its partners, for example, Mexico, South Africa, Middle East and North African (MENA) countries, and ACP countries. There is evidence from agreements with South Africa and Northern Africa that they have promoted liberalization and provided support for adjustment (Africa Trade Policy Centre, 2006). In the case of the Cotonou Agreement there is a provision for reinforced cooperation in policy formulation and efforts to progressively promote effective enforcement of policies. Such competition provisions include elements of negative and positive comity with respect to cooperation on cases as well as technical assistance and support in developing the competition culture and institutions in the concerned countries. Competition provisions are also included in some of the regional arrangements involving developing countries, for example the East African Community (EAC), COMESA and CARICOM. The EAC includes a Competition Bill prohibiting anti-competitive practices and a Competition Committee with the power to investigate and compel evidence (WTO, 2007, p. 25). A provision in Article 55 of COMESA bans restrictive business practices that distort trade within the future common market, although some exclusions are permitted subject to approval by the COMESA Council. Work is underway to develop a regional competition policy, suggesting a model appropriate to EPA discussions of competition.

The role of competition policy (indeed competition) in the development process is controversial. Governments of developing countries are concerned about the possible consequences of enforcing a broad competition law on several counts. First, that it

will limit their use of industrial policy in general and the protection of national champions in particular. This reflects the view that market mechanisms should be complemented by government intervention and industrial policy measures, at least in the early stages of development. Maximizing competition may not be optimal for promoting the long-run rate of growth of productivity. The example usually provided is that of the East Asian experience, where countries concentrated on achieving co-operation and competition rather than necessarily promoting greater competition *per se* (Singh, 2002). Second, that the prevention of private anticompetitive practices which restrict market access will make their markets more vulnerable to imports. Third, that stronger competition will tend to reduce domestic profit rates, discourage investment (including FDI) and entrepreneurship (Jenny, 2006). Fourth, in economies with a significant informal sector, concern arises that competition law will constrain only those firms operating in the formal part of the economy. Finally, there is pessimism about the ability of developing countries to implement competition laws, as to be effective they require a strong state (Singh, 2002).

The opposing view emphasizes the links between competition policy and economic growth and development (OECD, 2003, 2006). Foreign investors are more likely to be willing to invest in a country where there is an effective and transparent competition policy, insofar as this promotes a better business environment (see Morrissey, 2008). Deregulation and liberalization of financial and capital markets will enhance the attractiveness of operating in the formal sector. Competition policy can also force firms to become more efficient, increasing their competitiveness in both the domestic and export markets. There is no simple relationship between economic growth and a country's ability to implement interventionist economic and industrial policy, including competition policy. Optimal competition policy will differ between countries depending on their stage of development and the effectiveness of their governments as well as the supporting institutional framework.

There is some evidence that a more competitive environment is conducive to growth. OECD (2006) construct and analyse an index of pro-competitiveness, where the highest scores (lowest competitiveness) are in low-income countries (and lowest in high-income). The index comprises trade, investment and competition components, of which trade policy (followed by investment policy) seems to be most important in explaining cross-country differences. There has only been a slight improvement (lower index value) for low-income countries over the last five years. Countries with more pro-competitive policies (lower index values) exhibit higher trade levels than less competitive countries (mostly low-income). Improving competitiveness policy could have a significant impact on trade: if developing countries reduced their index to the level of OECD countries, their trade could increase by almost a third. This would contribute to an increase in per capita GDP by almost 8% on average (OECD, 2006: Table 4, p21)

Singh (2002) argues that it is important for developing countries to establish formal competition policies, primarily because of structural changes due to privatization and deregulation. Many privatized firms are natural monopolies while the international cross-border merger movement during the last decade (previous merger waves were mostly national) have seen firms trying to achieve a dominant position in specific markets and bigger size in a global market. Although the incidence of cross-border takeovers via FDI is much lower in developing countries as compared with developed countries, it is a trend. There are also mergers between large corporations within developing countries.

The main difficulty in reconciling these views is the lack of solid evidence one way or the other. This is largely a problem of measurement and reflects the variety and

range of practices that fall under the general ambit of competition policy. An advocate of strengthening competition policy in developing countries recognizes this ambivalence concluding that there are 'no convincing macroeconomic studies demonstrating the existence of a positive and strong correlation between the intensity of competition law enforcement and the rate of economic growth (in developed or developing countries). However, there is a fair amount of evidence that countries which engage in proactive competition policies designed to increase the intensity of competitive pressures (open trade and investment policies, regulatory reform etc.) tend to fare better than other countries' (Jenny, 2006, pp. 110-11). Perroni and Whalley (1998) quantify the potential gains of developing countries from the introduction of disciplines on competition as being as high as 5-6 per cent of national income. These gains include those stemming from the replacement of antidumping measures by competition law, reduction of mark-ups by foreign suppliers and reduced concentration in domestic markets.

One should not overestimate the extent to which these views are incompatible, or the extent to which there is a strong argument against promoting competition (provided it is 'fair', hence the value of competition policy). The concerns of developing country governments seem focused on markets and industries in the early stages of development. The considerable government direct and regulatory involvement provides some control over the types of firm behaviour otherwise subject to the scrutiny of a competition authority. But beyond some threshold the advantages of competition are more widely recognized. Successful privatization programs would founder if private monopolies or cartels replaced public monopolies. Furthermore, the sectors that are typically favoured by industrial policy have limited overlap with those where competition concerns are most common in developing countries (such as bus transportation, retail sales of food, petroleum or drugs distribution, basic construction materials, bakeries, and the distribution of water, gas and electricity) (ICN, 2003). Governments frequently exempt some sectors from the application of competition law. These often include those important for the preservation of cultural diversity (parts of the media for example) or those heavily regulated in any case (energy and parts of agriculture for example) (ICN, 2003).

Similarly the advocates of competition policy generally accept that, though it is always desirable, it may not be a high priority in the early stages of development. But they note that a competition policy will need to be introduced at some stage if the development process is successful, and they emphasize that it takes time to build a "competition culture" – and there is evidence that 'the existence of a competition culture was important for the success of Competition Authorities' (Holmes, 2003, p11). Until the 1990s most developing countries operated without a formal competition policy - formal competition policy was not needed because of the level of state control, price controls etc. State-owned enterprises were enjoined not to charge monopoly prices. It takes about ten years for countries to acquire the necessary expertise and experience to implement such laws effectively while the experience of developed countries indicates that it takes several decades before the full effects of CP enforcement on market behaviour are realized (Jenny, 2006).

The CUTS 7-Up Project (Holmes, 2003), a comparative study of the competition regimes of seven developing countries that had some sort of competition law and authority in place, four in sub-Saharan Africa (South Africa, Zambia, Kenya and Tanzania – the latter had only just introduced competition policy), and the others in Southern Asia, provides evidence that competition policy is both feasible and beneficial in developing countries. While the study was largely descriptive, hence it was difficult to reach general conclusions, on the basis that it is easier to refute

propositions 'we can reject the claim that a competition authority (CA) cannot possibly function in a least developed economy; and we can reject the claim that a good law is sufficient to ensure that an effective policy is implemented; most interestingly we can reject the proposition that a competition authority in a less developed country will never dare even attempt to stand up to a sceptical government' (Holmes, 2003, p4). Political will and a legal framework are prerequisites, and adequate resources and trained staff are necessary if a CA is to be able to tackle business interests. South Africa and Zambia both appeared to have fairly effective CAs, despite being at opposite levels of relative development. However, as shown in the next section, this did not prevent a high incidence of anti-competitive practice in these countries.

### *Prevalence of Anti-competitive Practices*

Developing countries exhibit segmented product markets, discretionary government regulations and considerable corruption, hence they tend not to have a very competitive environment. There are considerable barriers to entry and exit, and policies often favour large firms in access to finance and other measures. Firm concentration ratios in developing countries are quite high relative to advanced countries, although the share of small enterprises in total employment is higher in developing countries. This suggests a pattern that is likely to apply in most ACP countries: although there are numerous micro-enterprises, most sectors are dominated by a few firms, providing scope for abuse of dominant position.

Such abuse appears to be widespread. Recent efforts have uncovered reports and allegations of a wide range of anticompetitive practices, mostly associated with abuse of a dominant position. Jenny (2006) lists the following for Africa alone:

- Concentration in trade and (purchasing) price fixing agreements among traders – coffee in Kenya, cotton, tea, tobacco in Malawi, fish processors and exporters in the Lake Victoria region.
- Inflated prices for inputs, particularly chemical inputs – fertilizer tender cartel to Kenyan Tea Development Authority.
- Chicken price fixing – Zambia.
- Milling cartelization – Malawi, Zimbabwe, Zambia.
- Monopolies in foodstuffs- milk and sugar in Malawi
- Beer sector very concentrated in Zambia, South Africa, Kenya, Tanzania, Namibia – convincing evidence that mergers in this sector sometimes motivated to limit competition. Also rife with vertical restrictive agreements limiting scope for competition at the retail level – Zambia, Kenya.
- Soft drinks – acquisition of local bottlers by multinational firms results in high structural concentration – Kenya (merger part allowed by Kenyan competition authority). Anticompetitive vertical restraints – Kenya (quantity forcing, retail price maintenance or suggested retail price), Zambia.
- Retailing – South Africa.
- Passenger Transport (buses, taxis, airlines etc.) – Matatu owners cartel in Kenya, Taxis in Cape Town.
- Oil company cartel-like behaviour in Kenya, Tanzania, Uganda, Zambia (prosecutions for price fixing), Malawi, South Africa.

- Construction materials – Cement monopolies or cartels - Malawi, South Africa (officially sanctioned cartel to 1996), Tanzania and Zambia.
- Professional services – recommended Attorney fees - South Africa; health care fees – South Africa; surveyors' cartel – Zambia.
- Banking services – concentrated in South Africa and Uganda.
- Insurance services – price fixing in Kenya.
- Telecommunications – entry barriers by incumbents in South Africa; price fixing in Uganda; Zambia; Nigeria.
- Freight Transportation – trucking rates set by Operators' Association, rail monopoly, monopoly shipping service on Lake Malawi.
- Sugar cartel – South Africa.

**Table 1: Allegations of Anti-competitive Practices in SSA, by Type of Practice**

Type of Anti-competitive Practice	Entire Sample		Except South Africa		2002-2004		Cases Foreign Firms were Accused	
	Num.	%	Num.	%	Num.	%	Num.	%
Abuse of Dominant Position	39	6.32	16	3.73	24	6.58	10	8.62
Anti-competitive Merger	33	5.35	13	3.03	14	3.84	8	6.90
Barriers to Entry	8	1.30	6	1.40	6	1.64	0	0.00
Bundling	1	0.16	0	0.00	1	0.27	0	0.00
Collusion	55	8.91	29	6.76	31	8.49	10	8.62
Contractual Discrimination	4	0.65	1	0.23	2	0.55	1	0.86
Creation of a Monopoly	3	0.49	2	0.47	1	0.27	2	1.72
Cross-subsidization	3	0.49	1	0.23	2	0.55	0	0.00
Denial of Infrastructure	6	0.97	1	0.23	4	1.10	0	0.00
Exclusive Arrangements	23	3.73	9	2.10	10	2.74	6	5.17
Hoarding	4	0.65	4	0.93	4	1.10	1	0.86
Horizontal Agreements, Cartels	189	30.63	142	33.10	102	27.95	27	23.28
Minimum Resale Price	3	0.49	1	0.23	2	0.55	1	0.86
Monopolistic Practices	166	26.90	155	36.13	113	30.96	34	29.31
Predatory Pricing	27	4.38	17	3.96	18	4.93	9	7.76
Tying	3	0.49	1	0.23	2	0.55	1	0.86
Vertical Agreements	7	1.13	3	0.70	5	1.37	2	1.72
Violation of Merger Control Regulations	5	0.81	1	0.23	5	1.37	0	0.00
Unspecified Practices	38	6.16	27	6.29	19	5.21	4	3.45
Total	617	100.00	429	100.00	365	100.00	116	100.00

*Note:* The entire sample covers the period 1995-2004; the columns for 2002-04 show how the incidence (at least of reporting) has increased significantly in recent years..

*Source:* Evenett, Jenny, and Meier (2006), [www.evenett.com/ssafrica.htm](http://www.evenett.com/ssafrica.htm)

Further recorded allegations of uncompetitive behaviour are reported in Evenett *et al* (2006) as shown in Table 1. The reported allegations are derived from a database of allegations of private anti-competitive practices made in SSA publications, principally in newspapers and other periodicals. Since these are allegations the findings from this approach must be interpreted with caution. Nonetheless, this database represents the first comprehensive attempt to assess the prevalence of different types of private anti-competitive practices in SSA. A total of 515 different allegations of anti-competitive practices in 41 business sectors affecting 34 African countries were recorded since 1995. By a large margin the most frequent allegation reported concerns business operators forming cartels, especially outside of South Africa – which would indicate the presence of a relatively strong anti-cartel policy stance in South Africa (there is some support for this in Holmes, 2003). Allegations against foreign firms, some of which are South African operating elsewhere on the continent, account for one fifth of the total number of allegations.

Another feature evident in Table 1 is that the incidence of allegations increased significantly in 2002-04, which accounts for a substantial share of the total in the sample period 1995-2004. Evenett *et al* (2006) show that South Africa accounts for about a third of all allegations, which can be attributable to its relative size. What is perhaps more interesting is that only ten other countries have 10 or more allegations apiece, ranging from Kenya (57), Zimbabwe (41), Cote d'Ivoire and Zambia (40 each), to Nigeria (24), Malawi (17), Uganda (11) and Congo DR (10). Some 33 countries have fewer than 10 allegations: neither relative size nor income is a robust indicator of the number of allegations (Kenya and Zambia are small and poor relative to Nigeria, and Malawi in particular seems 'over-represented'). Although allegations are evident in almost all sectors, they are most common in manufactured foods and beverages, telecommunications, oil, air transport, land transport and chemicals. As noted above, OECD (2006) identifies potential gains from implementing pro-competition reforms, including competition policy, in telecommunications (and, to a lesser extent, in transport sectors).

Jenny (2006) draws the following lessons from his empirical survey:

1. There is considerable scope for anticompetitive practices in developing countries in terms of both the variety of practices and sectors in which they occur.
2. There are many instances of anticompetitive practices in countries such as Kenya, Zambia and Zimbabwe, where there is very little political support for existing competition institutions and where Government officials routinely assert that competition law enforcement is neither useful nor necessary for developing their country.
3. Many anticompetitive practices or transactions emanate from local firms, sometimes sizable regional firms (e.g. beer in Africa). MNEs are not the only source of anticompetitive practices affecting developing countries.
4. The proposals for potentially anticompetitive mergers involving firms that are simultaneously present in several neighbouring developing countries, and the fact that such firms appear to pursue regional strategies in terms of investment, marketing, production, employment and competition (e.g. beer, cement) suggests benefits from regional agreements on competition law enforcement.
5. Anticompetitive practices particularly affect poor consumers.

6. Poor farmers are often victimized by the large firms that supply their inputs (chemicals, fuel, banking, insurance), intermediaries (traders in tea, coffee, tobacco and fish) and operators of freight transport.
7. Anticompetitive practices also involve key industrial inputs (steel, aluminium, sugar).

Although there is considerable evidence that anti-competitive behaviour is widespread, there is little direct evidence on the costs of such behaviour in developing countries. The pioneering study on cartels (Levenstein and Suslow, 2001) estimated that products of the 19 international cartels prosecuted during the 1990s represented nearly 5.2% of total imports of developing countries and 1.25% of their GDP. The estimated annual over-charge of imports to developing countries was \$15-25 billion, equivalent to 33-50% of the annual aid provided by developed countries (Jenny, 2006, p. 112).

Furthermore, there is little evidence that would allow one to quantify the benefits of a competition policy (e.g. the CUTS study includes no such evidence). In part this is because competition laws in different countries vary considerably according to definition of dominance, treatment of cartels, and enforcement (see World Competitiveness Yearbooks, and Singh, 2002). One could identify cases where the presence of competition policy, or CAs in the case of the CUTS study, lead to action being taken against particular instances of anticompetitive practices. Indeed, if the actions were demonstrably effective it may even be possible to identify positive benefits (e.g. reductions in prices). However, it would rarely be possible to generalize this to an impact on GDP or growth. This does not imply that competition policy is not beneficial, simply that the benefits are hard to quantify.

### **3 Issues in Establishing a Competition Policy**

The OECD (2003) argues that there are three broad components to building an effective competition policy for developing countries, and provides a useful review of issues, especially regarding the design of competition policy. The first is creating a competition culture. This involves persuading stakeholders, including politicians, officials, business groups, labour groups, the legal fraternity, regulators, academics and the press, of the merits of competition. As Holmes (2003) notes, political will and a legal framework are prerequisites, but adequate resources and trained staff are necessary if a CA is to be able to tackle business interests. 'The cases involving FDI that were researched suggested that foreign investors did respect a credible CA, and that competition policy should *not* be seen as an additional bureaucratic obstacle to entry' (Holmes, 2003, p12). The problems associated with establishing the appropriate 'standing of the CA' amongst the relevant stakeholders are analysed in ICN (2003, Chapter 2, which also provides a discussion of relevant experience in developing and transition countries). Those suspicious of competition law are likely to be well resourced and politically influential.

The second component is correcting structural and institutional distortions in an economy characterized by concentrated, non-competitive structures. These may be dominated by state-owned enterprises, in which case privatization or corporatization may be a necessary step. They may also reflect inappropriate and inefficient regulation, particularly of the network infrastructure such as transportation, telecommunications, energy, and financial and professional services. The third, is putting in place an effective enforcement mechanism for dealing with private

anticompetitive conduct. The prevailing view is that openness to trade will not be enough for most economies, i.e. allowing imports may be insufficient to introduce competition. Many markets are local in character and insulated from the discipline of international competition.

To fulfill these three components, the CA will need to perform two broad functions – enforcement of competition law and advocacy of competition policy. The relationship between the CA and the Government will have a significant bearing on how it performs these functions. There seem to be two dominant models of this relationship (ICN, 2003). One is for the CA to be firmly established in the executive apparatus, with strong formal powers and influence over legislation and government interventions that affect competition. This model has proved popular in transition economies where extending markets and defending markets from the state is a priority. In the second model the CA is separate and independent from the government. This gives it greater freedom in enforcement decisions, but implies that its influence over government actions will depend on its powers of advocacy and degree of political support. This model is more appropriate where markets are firmly established.

Because the establishment of a competition culture takes so long it is best to start the process early. This suggests enacting a Competition Law with limited application in the first instance. The idea would be to choose an area where it is most likely to be visible and effective, and to then strengthen the Law as experience is gained and credibility is established. A country newly adopting a Competition Policy is likely to be characterized by markets with a high concentration, a history of state intervention, a newly established Competition Authority with limited resources and enforcement capabilities, and a lack of political will to enforce the Law against powerful interests. For this reason an initial focus on “hard core” cartels is recommended. These cover Agreements to fix prices, restrict output, submit collusive tenders or share markets by allocating customers, suppliers, territories or lines of commerce. They involve a particularly serious and harmful form of anti-competitive conduct (OECD, 2003), and are not generally associated with any legitimate economic or social benefits. Such behaviour is prohibited in almost every national competition law. Cartel enforcement is considered a highly promising field for a new CA, because a large number of horizontal anticompetitive agreements are likely to be present, and, while their detection requires wide ranging investigatory powers, their prosecution does not require as much economic expertise as other types of anticompetitive practices. It is noted that cartels can operate effectively through tacit collusion rather than explicit agreements in small or highly concentrated markets. In some cases competition law includes provisions allowing a CA to infer an anticompetitive agreement from parallel behaviour (e.g. the steel cartel in Brazil, Jenny, 2006, p. 136). However, other agreements, such as Research Joint Ventures, could be considered as legitimate approaches to reduce costs or increase efficiency. The evidence suggests that for developing countries the cost of a CA is small relative to the cost of cartels (ICN, 2003).

Success in anti-cartel efforts depends on international cooperation as cartels operate in secret and important evidence may be located abroad, whilst international cartels grow in importance as markets become global. It is therefore difficult for a single national authority to prosecute without cooperation, and this provides an argument for establishing regional authorities, even if their remit is fairly limited. This is particularly relevant in the context of EPAs: although regional institutions tend to be quite weak, EPAs could include measures to support regional cooperation on competition policy. Given the market power of large multinationals, even with

legislation regional authorities may not have the power to restrain cartels and other uncompetitive conduct. Problems include inadequate development of the legal and institutional framework, lack of information and difficulty of establishing evidence. Anti-cartel legislation in advanced countries does not normally extend to developing countries, e.g. exports are often exempted. The implication is that developing countries would require co-operation from advanced countries to cope with anti-competitive behaviour of advanced country cartels between the large multinationals. However, the CUTS study suggests that domestic systems can work. Although 'several of the CAs observed felt that they were wholly powerless to intervene in the case of mergers by multi-national firms operating in their markets ... those that did seek to intervene found that they could do so effectively' (Holmes, 2003, p8).

Whether a new CA should also be given merger control powers is also controversial. On one side is the argument that the issues involved can be too complex for a new and inexperienced Authority. On the other side is the view that a new CA can develop a reputation more easily and quickly in merger cases, because the notifying parties have a duty to provide the relevant information. As countries liberalize they open up opportunities for cross-border mergers and alliances, *inter alia*. From a competition policy point of view, mergers and alliances create a dominant market position which undermines competition in the affected markets. This is not to deny that under certain conditions mergers (at the aggregate level) can be profitable to participants and socially desirable (due to economies of scale) in a closed economy as well as in an open economy (Falvey, 1998).

Enacting a sound competition law is a step towards participation in international cooperation in the competition policy area. A country must acquire a reputation for fair and effective enforcement and have effective procedures for protecting confidential information. There are obvious benefits from cooperation in merger cases, including avoiding inconsistent or conflicting rulings and duplication of efforts, although (international) cooperation may be inhibited by (national) confidentiality requirements.

For very small countries regional cooperation may be the only viable competition policy strategy. It 'is quite likely that the cost of establishing a competition authority in small economies (such as, for example, the small island economies of the Caribbean), or in some of the least developed countries of Africa, may be very large compared to the resources of the country ... Furthermore, given the relatively small size of the national markets in these economies, most competition problems may best be handled in a regional context' (ICN, 2003, p23).

Competition law and its enforcement through multilateral agreements will likely be subject to the core principles for multilateral arrangements (OECD, 2003):

[1] *Non-discrimination*. The most relevant aspect here is national treatment. It is possible that laws implementing industrial or other types of public policy could be excluded from coverage. As noted earlier, exemptions, exceptions and exclusions from competition laws are commonplace (export cartels for example). For least developed countries there may be circumstances where the application of the special and differential treatment (S&D) concept is appropriate.

[2] *Transparency*. At the international level this has two components: (a) the obligation to make publicly available all relevant laws, regulations and decisions; (b) provision for notification of forms of government action to the members of the arrangement. Genuine transparency requires that the CA disclose both the substantive basis for its decisions and the procedures by which it arrives at them. Transparency in both process and decision-making is also important in establishing a

reputation for impartiality, objectivity and independence from the undue influence of government or business (ICN, 2003).

[3] *Procedural fairness*. It is accepted that administrative and judicial procedures vary substantially across countries. Protection of confidential information from unwarranted disclosure is seen as particularly important.

Whether competition policy is to be adopted at a regional or national level, it is clear that governments and newly established CAs can benefit from the experience of others, particularly those who underwent the same process at a similar level of development. In paragraph 24 of the Doha declaration the ministers recognized the "need of developing and least-developed countries for enhanced support for technical assistance and capacity building" in competition policy. OECD (2003, pp36-38) discusses the many forms that technical assistance and capacity building can take, from large conferences to internships. It also describes (pp26-33) peer review mechanisms that can be used to inform both directly involved parties and the public in general about international best practice. These can help prompt reform from within, contribute to transparency, and are a mechanism for sharing information and experiences. They may also bring about convergence in law and policy over time.

#### **4 Improving Public Procurement**

Many developed and developing countries have undertaken reforms of their national procurement systems aimed at ensuring that public funds are used in the most efficient and economic way and that the system delivers value for money. Increasingly, governments recognize the (financial) savings from a better organized and transparent procurement system (Hunja, 2003). The main objectives of the public procurement reforms are value for money, efficiency, transparency, probity and accountability (Arrowsmith, 2005). A related issue is opening up of the procurement market to foreign competition, where agreements have been reached at both the regional (e.g. EU) and international (e.g. GPA) level. The rationale behind opening up public procurement is that protectionist measures in public procurement can constitute barriers to trade (and competition) that promote costly inefficiencies (Atkins Study, in *The Cecchini Report* 1988).

Given the size of government procurement,<sup>1</sup> enhancing both the efficiency of the procurement process through targeted reforms and opening up procurement to foreign competition can bring significant advantages to governments. Studies on the effect of opening up procurement to international competition show that competitive procurement practices promote efficiency in public spending and help public authorities acquire cheaper, better quality goods and services at lower costs; European Commission (2004) suggests that enhanced competition and transparency reduce prices by around 30%. Open, non-discriminatory and transparent procedures can also help boost the competitiveness of firms operating in public procurement markets (*The Cecchini Report* 1988).

The theoretical literature on the effects of public procurement on international specialization and trade flows is limited. Most studies have focused on microeconomic aspects related to the efficiency of the tendering process. A recent review of the literature on the effects of discriminatory procurement (Trionfetti, 2003) illustrates the effects that favouring home suppliers and products can have on international

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<sup>1</sup> For instance, According to a study by the European Commission, in 2002 the total EU procurement market was worth €1.5 trillion or over 16% of EU GDP.

trade. Whether home-biased procurement influences trade flows and international specialization depends on the market structure (which might change from sector to sector) and on the size of government procurement. In particular, discriminating procurement is likely to influence international specialization in sectors characterized by monopolistic competition and increasing returns. Trionfetti (2003) shows that two types of inefficiencies may arise as the consequence of discriminatory procurement: inefficient production of government output and inefficient specialization of the country. Evenett and Hoekman (2005) argue that fostering either domestic competition or transparency in state contracting tends to improve national welfare. They find no clear-cut effect on market access of ending discrimination or improving transparency.

While there is a large literature on the effects of liberalising procurement within the European Union, given the many studies carried out for the Commission (indicating significant benefits), there are few studies reporting data on procurement for ACP countries. The information available on the size of the procurement market in developing countries, and ACP states in particular, is sometimes contradictory and vague. For instance, World Bank (2003) reveals that in India total<sup>2</sup> procurement amounts to US\$100 billion. The WTO's Trade Policy Reviews show that Malaysia spends some 20.6% of GDP on procurement (WTO Trade Policy Review, doc WT/TPR/S/156, 2006, p. 47); Colombia spent, in 2004, between US\$7,900 and \$13,000 million on procurement (doc WT/TPR/S/172, 2006, p. 82); and in Kenya government procurement is estimated at some 8% of GDP (doc WT/TPR/S/171, 2006, p. A1-65). For ACP countries in general, procurement is contestable procurement (i.e. procurement that is potentially open to competition) is likely to be equivalent to 5-10% of GDP.

However, when considering the size of contestable procurement in developing countries one has to take into account that a considerable part of procurement in ACP states is financed through aid which is very often tied to the procurement of goods and services from the donor country (i.e., irrespective of the Government's own policy, procurement is not open). This has consequences in terms of the scope of an agreement on procurement between the EU and ACP states. Indeed if the aid is tied, procurement needs to be limited to goods/services originating in the donor country only, thus the scope of an agreement for opening up procurement is reduced (see below).

A further point that needs to be considered when the term public procurement is defined is whether the definition adopted includes public undertakings and local authorities (OECD, 2002). The exclusion of purchases by public undertakings and local authorities could result in big differences between states both when defining the size of the procurement market and when assessing the impact that any agreement on procurement could have. Indeed, if procurement will be defined as to exclude, from the coverage of the procurement agreement, public undertakings and local authorities, the size of the procurement market risks being underestimated and the impact of the procurement agreement itself will be weaker in those countries where public undertakings and local authorities play a central role compared to countries where procurement is mainly carried out by central authorities. Therefore, any future EPA agreement on procurement will have to carefully consider which entities will be

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<sup>2</sup> Procurement of goods and services carried out by ministries, departments, municipal and other local bodies, statutory corporations and public undertakings both in the Centre and in the States.

covered, after a thorough analysis of the procurement markets of the EPA countries involved.

### *Gains from Transparent Procurement*

Following the literature, the gains from more open procurement are considered in respect of enhanced transparency, increased competition and reduced corruption. As Trepte noted there are three main aspects of transparency: what transparency is, why it is desirable and what are the consequences of a non-transparent procurement system (Trepte, 2004). Many trade agreements on procurement prohibit discrimination and include transparency requirements to support and render effective this prohibition. In this respect, transparency rules are aimed at preventing public authorities from concealing discrimination in favour of national suppliers and goods. As Arrowsmith pointed out, transparency rules also support other objectives such as probity, preventing corruption (see below), deterring abuse of discretion, maintaining the confidence of contractors in the system and are also used as a means to prevent covert discrimination (Arrowsmith, 2003).

It is therefore reasonable to assume that an agreement in EPAs will include transparency rules (as it should).

Transparency in procurement requires similar principles as applied for competition policy above, i.e. clear rules and clear procedures for implementing the rules. Transparency entails that procurement procedures should be "characterised by clear rules and by means to verify that those rules were followed" (Westring and Jadoun, *Procurement Manual for Central and Eastern Europe*, p.6). The literature consulted reveals that three factors are essential for a public procurement regime to be classified as transparent. Firstly, the existence of clear public procurement rules is required. All participants should be informed about the procurement rules that will be applied by the contracting authority (for instance what are the criteria for selecting the suppliers, for awarding the contract etc). The existence of clear rules allows participants in the procedure to know in advance how it will be conducted and to behave accordingly. Secondly, procurement opportunities should be public in order to enable all possible interested suppliers to participate (this is achieved by publishing procurement opportunities on national, regional and international bulletin/newspapers); and thirdly the opportunity should be given to scrutinise decisions and to enforce the rules in order to ensure that the procurement agency has adhered to the rules and that the decision was not motivated by self-interest but was taken having regard only to commercial consideration.

A lack of transparency can impede the ability of foreign firms to bid for contracts even if there is no intended discrimination (Arrowsmith, 2003). When a procurement system is characterised by non-transparent rules foreign suppliers can be reluctant to enter the market, "as bidders must trust in the fairness of process to participate in a tender, the perception of transparency is crucial in attracting the largest possible number of tenders and increasing competition" (ADB/OECD 2006). The result of a lack of transparency can be a substantial loss for governments' budgets. Case studies reveal that excess costs can be in the range of between 25-50% (Rose-Ackerman cited in Evenett and Hoekman, 2005). Another possible effect of a non-transparent system is an increase in the information costs, which, in turn, raises the marginal costs of firms and so the prices of the goods/services (Evenett and Hoekman, 2005). Further, the lack of transparency can be the result of corruption

and self-interest of procurement officials. The importance of transparency is that it makes visible what would otherwise be disguised and allows the actions of the procurement agency to be scrutinised and monitored (Trepte, 2005).

Many are the measures usually implemented for achieving transparency, including making procurement laws and administrative regulations publicly accessible; ensuring broad advertisement of procurement opportunities in journals of national and international relevance (for instance EU Member States are required to advertise in the EU official Journal procurement opportunities falling within the EU procurement directives thresholds); limiting the use of negotiated procedures to very limited and well defined cases giving preference to the use of more open procurement methods such as open tendering or restricted procedure; give the possibility to all bidders to be present at the opening of tenders; the requirement that all criteria for evaluating tenders shall be stated in advance in the contract documents.

An additional, important, element of any transparent procurement system is ensuring that suppliers are giving the possibility to complaint against a procurement decision and that there are in place effective and independent review and complaint systems.

However, there are also potential costs of multilateral rules on transparency (Arrowsmith, 2003; Rege, 2001). For instance, running a procurement competition through an open procedure is more costly than running it through a negotiated procedure. Constraints on substantive discretion can affect the entities' capacity to achieve value for money, or can render too burdensome and lengthy the procurement process. Further, transparency rules alone are not sufficient to ensure probity (see below). Therefore, careful attention is to be paid to the rules to be chosen to achieve transparency. The rules need to take into account the characteristics and preferences of the regulated jurisdiction.

Transparency rules are common in the EU and are embodied in the EU procurement directives. Rules on advertisement of procurement opportunities, time limits, notification of the award of the contracts etc. are all aimed at increasing transparency and at ensuring a level playing field between suppliers of different nationality (transparency rules are also present in the GPA). Many studies relate to the benefits from opening up procurement and from increased transparency within the EU (to realize benefits, opening up must be with transparency rules). However, in the EU effective competition in the procurement market is facilitated by the fact that enterprises registered in one EU country have got freedom of establishment (for instance by setting up subsidiaries) in other EU countries, standards of products are harmonised and direct and indirect barriers to trade are generally abolished. Further, the legal system within each EU country and the European Court of Justice ensure that EU rules are actually and effectively enforced. This needs to be taken in mind when devising agreements on procurement in EPAs, the full benefits of an open and transparent procurement market cannot occur without correlated institutional reforms.

Transparency is often considered a value in itself and interested parties, from both the EU and ACP side, could take into consideration the possibility of reaching an agreement on transparency only, which does not involve market access and the ban on discrimination against foreign suppliers. A transparency agreement on government procurement could be thought to have beneficial effects and to result in enhanced market access. However, if the agreement is limited to transparency only without any provision on non-discrimination and market access, the benefits are significantly reduced (Arrowsmith, 2003). Some recent studies on an agreement on

transparency in government procurement negotiated within the auspices of the WTO have demonstrated that the possible effects of an agreement concentrated solely on transparency (without also opening up) are limited (and likely to fail, given the renowned reluctance of developing countries to sign up to it). Evenett and Hoekman (2005) have shown that there is no clear-cut relationship between transparency in procurement and market access. This has cast doubts on the magnitude of the potential benefits of embedding rules on transparency in government procurement in trade agreements- whether multilateral or regional. Evenett and Hoekman (2003) argue that if the self-interest of procurement officials motivates non-transparency, any market access gains from introducing transparency are likely to be less than if non-transparency was motivated by protection.

### *Enhancing Competition and Reducing Prices*

The evidence gathered from studies conducted on the effects of the procurement directives enacted in the EU suggests that public procurement prices paid by public authorities in the EU are lower when the directives are applied. The application of procurement rules appears to reduce prices by around 30%. Price reduction is due to enhanced competition. It is evident that in a situation of tight budgets, a saving of 30% on government purchases can be extremely beneficial. European Commission (2004) shows that in a sample of firms involved in procurement activities, 46% carried out some type of cross-border procurement. However, direct cross-border procurement remained low, accounting for just 3% of the total number of bids submitted by the sample firms. The rate of indirect cross-border public procurement is higher, with 30% of the bids in the sample being made by foreign firms using local subsidiaries. Therefore, one element that seems very important is the possibility to set up subsidiaries in the host state; in this context, open procurement could attract investment and foster competition.

Given the size of public procurement markets the importance of these improvements is clear. Competitive, transparent procurement markets help government acquire goods and services at lower cost. For effective competition to maximise the effects of opening up procurement it is important that firms have the possibility to set up subsidiaries in the host country. If the advantages of an agreement on procurement are really to be achieved any EU proposal in EPAs should include provisions for facilitating setting up business in the third country (this is related to measures on foreign investment, see Morrissey, 2008).

### *Reducing corruption*

The public procurement process can provide opportunities for corrupt officials to engage into illegal practices (Trepte, 2005). Corruption in public procurement is a big problem for developing countries because it leads to a significant waste of (already scarce) public funds. According to the World Bank specialist Uzma Sadaf, in developing countries 20-25 percent of spending on procurement is lost due to leakages and malpractices. Hence, a large portion of funds goes to waste. For instance, she estimated that the total GDP of Pakistan was \$112 billion in 2004-05. The anticipated public procurement was \$17-22 billion in that period, under which, a loss of \$3.4 - 5.5 billion is considered under the leakage percentage criteria.<sup>3</sup>

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<sup>3</sup> ResponseNet, Posted: Monday, January 22, 2007 10:34:50 available at <http://216.239.59.104/search?q=cache:OQVKtYOfIVAJ:www.responsenet.org/show.>

As Arrowsmith *et al* noted corruption in public procurement can cover various types of practice and can involve various forms of collusion between government and bidders. For instance:

- the procurement entity may award contracts on the basis of bribes rather than on the basis of the best quality and price of the products;
- contracts may be awarded to firms in which one has a personal interest;
- contracts may be awarded to political supporters

Corruption can occur in the execution as well as award of contracts e. g. officials can collude with bidders to allow them to claim extra payments for non-existent work (Arrowsmith et al, 2000). The procurement planning and the delivery phase are particularly exposed to corruption and need to be carefully monitored (ADB/OECD 2006). The award of contracts on the basis of corruption will prevent authorities achieving value for money, since contracts will not be awarded to the best firms and for the best products. Further, corruption scandals may deter both national and foreign firms from bidding for future contracts. Prices may be higher both because contractors do not face real competition and because contractors need to insert in their "costs" the bribe paid to procurement officials.

Procurement measures for combating corruption include transparency measures (as seen above); conflict of interest rules; criminal penalties on bidders; procurement penalties on bidders: exclusion and debarment. However, "Procurement regulation is able to close off a number of those opportunities but it cannot address the wider causes or prevalence of corruption" (Trepte 2005).

As Trepte points out corruption in developing (and developed) countries is due to many reasons and often related to the structure of government itself, especially the low pay of employees (Trepte, 2005). Corruption also depends on many factors related to the society itself and on how corruption is socially perceived (Linarelli). Corruption also depends on the lack of mechanisms to make redundant officials who have been proved guilty of corruption. Corruption depends on the lack of enforcement and monitoring systems and on the lack of an effective system of debarment for suppliers who have been accused of corruption.

These problems need to be addressed if procurement rules aimed at fighting corruption are to be successful. Procurement rules alone cannot solve the problem of corruption. It is often thought that imposing the use of open procedures and limiting, to the maximum possible extent, the discretion of procurement officials is sufficient to fight corruption. However, this has proved to be unsuccessful and to have just increased the administrative burdens of the public authority. As Trepte (2005) points out, a balance needs to be struck between the need to curb the inappropriate use of discretion in the hands of procurement officials and allowing those same officials to exercise the professional judgment for which they were recruited and trained.

Some suggestions are offered below for limiting the opportunities for corruption at the stage of the procurement process. These suggestions are made having as point of reference the UNCITRAL MODEL LAW on procurement (which is the model law that many developing countries use for reforming their national procurement system) and the abundance of literature on this subject.<sup>4</sup>

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[detail.asp%3Fid%3D3645+said+procurement+specialist+World+Bank+Uzma+Sadaf,+on+Wednesday&hl=en&ct=clnk&cd=3&gl=uk](#)

<sup>4</sup> This list is indicative only and by no means exhaustive.

- The criteria for the selection of suppliers could be set by law or regulation and the procuring authority should be bound by those criteria, in so limiting the discretion of the public authority and avoiding the use of ad hoc solution aimed at favouring corrupted bidders (if a legislative process needs to be activated whenever a change to the criteria wants to be introduced the opportunity for corruption will be reduced).
- Another guarantee could be to pre-disclose the selection criteria to bidders and to forbid the procurement entity to change them once the process has started.
- At the specification stage it is important that specifications related to the product are not too burdensome and technical for suppliers to comply with them. Indeed, specifications can create unnecessary obstacles for the participation of bidders. The costs at this stage can be very difficult to monitor and weigh. When it is too costly to comply with national standards bidders could decide not to participate at all. At this stage it could be very easy for the procurement entity to set forth criteria that can be met just by very few and specific suppliers. This is so especially when the specifications are too technical and too specific without a real necessity. Any chance of competition is cut at the very first stage and without any opportunity for calculating the effective costs that such operations involve. This is why, as Arrowsmith *et al* note, specifications should be described in terms related to the function of the product rather than to trade-mark, name, patent or with reference to international standards rather than national ones (Arrowsmith *et al* 2000).
- Caution is also necessary at the qualification stage, the selection of suppliers in order to consider who is eligible for the contract. If a procuring entity is left with too much discretion at this stage there is the risk that some suppliers are opportunistically excluded from competition. Manipulation by the procurement entity can be easy at this stage and so it is necessary that the criteria for the exclusion of bidders are clearly set forth (Arrowsmith *et al*, 2000).
- As far as the award stage is concerned, contracts can be awarded according to the lowest price (which is possibly the most transparent way) or according to the lowest evaluated tender. In the latter case it is important that the evaluation is made on the basis of criteria that have been previously specified in the qualification documents. The criteria need also to be *objective and quantifiable*, by for instance giving them a relative weight or being expressed in monetary terms.
- A system should be in place which allows aggrieved suppliers to challenge the decisions of the procurement entity. Complaints should be dealt with, in a fast manner, by an independent, impartial and unbiased authority. The introduction of a quick and effective challenge/review procedure is essential to ensure probity and build suppliers' confidence in the system.

## 5 Procurement: Concerns and Problematic Issues

Notwithstanding the gains that a system of free competition in procurement can bring, developing countries have been reluctant to join international agreements aimed at opening up public procurement to international competition and, in general, other type of agreements regulating procurement. For instance, within the WTO forum, reaching an agreement just on transparency in government procurement has proven unsuccessful partly because of the opposition from developing countries.

Developing countries asked at the Cancun Ministerial meeting of the WTO in 2003 that the negotiations on transparency in government procurement be dropped from the negotiating agenda. In July 2004 the General Council actually made a decision to drop this as a negotiating issue during the Doha work programme. In this context, the EU proposal to include some commitments on procurement in EPAs with ACP states is very ambitious. Understanding the reasons why developing countries are reluctant to opening up public procurement to international competition and to reach an agreement on procurement at the international level is essential if a proposal by the EU to include procurement in EPAs is to be successful.

It must be stressed that any discussion on how ACP countries could determine their negotiating position on procurement in EPAs must be mainly based on their revealed position on accessing the GPA and other WTO agreements. Formal EPA negotiations have not moved yet to a stage where market access issues on government procurement have been discussed and the official EU proposal on expanding the scope of the EPAs to government procurement is quite broad (based on the GPA and emphasizing transparency, national treatment and special and differential treatment). Consequently, ACP countries have not yet expressed a formal view on what negotiating position they will endorse on including procurement in EPAs (although they have indicated resistance to the idea). Furthermore, there is scant empirical evidence on procurement in ACP countries; general discussions/doctrinal debates on the benefits for developing countries' of accessing multilateral agreements on opening up trade in general and procurement in particular have been used as benchmarks.

One of developing countries' major concerns<sup>5</sup> for reaching an agreement on procurement is related to market access (Khor), in particular the perception that they are unlikely to derive any benefit from EU procurement while exposing their own firms to competition from the EU. There are also concerns about allowing foreign firms access in 'sensitive' markets, although these could be addressed through exceptions. In relation to a multilateral agreement on procurement Arrowsmith has noted that developing countries may be concerned with a reduced ability to use procurement to promote secondary policies (Arrowsmith, 2003), such as favouring disadvantaged groups in society, small enterprises or women. This is the case for South Africa where the use of procurement as a means to achieve secondary policies is required by the Constitution.<sup>6</sup> This concern has arisen in relation to developing countries joining the GPA and a transparency agreement on procurement.

Specific concerns arise in the case of tied aid (Rege, 2001), when donor countries specifically require recipient countries to purchase the goods for the aid financed

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<sup>5</sup> For developing countries' opposition on WTO negotiations on market access in procurement the Working Group on Transparency in Government Procurement lists the issues raised and points made at: Information Note by the Chair, 5<sup>th</sup> revision, 24/9/1999, JOB(99)/5534

<sup>6</sup> For instance, in relation to the accession to the GPA, the fear that the accession to an international agreement on procurement could compromise the possibility to use procurement to promote social goals, has lead South Africa to adopt the view that "it might be opportune to resist accession to the agreement" as an official position Summary of *Green Paper on Public Sector Procurement Reform in South Africa*, Ministry of Finance and Ministry of Public Works, April 1997, Notice 691, Government Gazette, Vol. 382, No 17928

project from donors' suppliers and/or products only. Tied aid is a practice widely implemented among donor countries, including some EU Member States, when they grant bilateral aid. Although aid granted by the EU is mostly untied, this is not the case for aid granted bilaterally by all individual EU Member states (only Britain and Ireland are declared as completely untied). As a large proportion of public investment is aid-financed, and the EU and its member states are collectively the dominant donors to ACP countries, substantial procurement is effectively financed through aid. The extent to which procurement is financed through tied aid will affect the scope of any agreement on procurement in EPAs.<sup>7</sup>

One possibility that the EU should consider for rendering any agreement more appealing to ACP countries is the commitment that, if an agreement is reached, it will lobby (commit) the individual EU Member States that have not already done so to untie their bilateral aid. In this way the procurement financed through EU member States' bilateral aid is fully subject to any new agreement. Such a commitment would provide policy coherence and would ensure that any agreement reached with the EU on procurement brings to ACP countries potential *development* benefits.

Another problem that might occur is related to the procurement rules that will be applied. For instance, new rules might conflict with national procurement reforms (where these have been undertaken). Additionally, possible problems might occur with other donors' procurement rules (such as the World Bank). These two points are also linked to harmonisation of procurement rules and administrative costs highlighted below. One suggestion that could be made is to refer to the UNCITRAL Model Law on procurement when drawing the procurement rules that should be applied. Indeed, the Model law has already been used by many developing countries in order to reform their procurement systems.

A related problem is that the EU might propose procurement rules that are inconsistent with ACP countries' national procurement rules and/or impose further extra burdens to the administrative staff of ACP countries. For instance, the problem of harmonising procurement rules is very acute in relation to aid procurement. As shown in a study conducted for the OECD in Mali, a number of failings in terms of aid effectiveness and Mali's ownership of aid were caused by the multitude of public procurement procedures applied. (OECD/DAC, 2000). The many, complex, procedures specific to each donor created a rupture with the newly reformed Malian system of procurement. Although the donors' and the Malian government's procurement procedures had common objectives and principles, the donors' procurement procedures were very different to those of Mali in terms of the devolution of decision making power to the local agencies, procurement thresholds

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<sup>7</sup> The Commission has argued that granting tied aid infringes the EC internal market rules only when the procurement process is carried out by the EU Member States. However, in the majority of the cases the procurement process is instead carried out by the recipient country. Although in this latter eventuality the infringement of EU Law is less straightforward, it is present. La Chimia (*European Law Review*, 2007) argues that tied aid infringes EU Law even when the procurement process is carried out by the recipient country, because the tied aid condition, which is the cause of the discrimination, is imposed by the Member State. The recipient country, if it wants the aid, has no real choice but to fulfil the tied aid condition. Support for the view that Member States breach the EC Treaty provisions on free movement of goods when they set tied aid conditions can be found in the *Open Skies case* (Case C-476/98, *Commission v Federal Republic of Germany* ('Open skies') [2002] E.C.R. I-9855 at paras. 144-162).

and specific awards and payments methods. The OECD study suggested that to remedy this situation the easiest choice should be to align with national procedures.

Implementing new procurement rules might have high administrative costs for ACP countries. Applying new rules involves resources, training of staff and even changes in the law. Many of these countries have recently implemented costly procurement reforms (or are in the process of implementing them). New rules might risk undermining and nullifying these efforts. Therefore a cautionary approach is necessary. The rules will need to take into account the specific situation peculiar to each ACP country, as 'one size does not fit all' in this context.

A final factor to take into account is the possible accession to GPA of some EPA states (there are no problems with WTO in terms of public procurement because public procurement is exempted from the coverage of the GATT and GATS, although EPAs in general will have to comply with GATT Art. XXIV). Although no ACP countries are members or candidates to access the GPA at present, this situation might change (especially considering the pressure on developing countries to access the GPA). Since the EU is a member of the GPA it is essential that all EPA procurement rules are compatible with the GPA. The same would have to apply if any ACP country wished to accede to the GPA.

## **6 Final Considerations and Implications**

Competition policy can be defined as a set of measures employed by government to ensure a fair competitive market environment, typically involving competition laws and Competition Authorities. Competition policy aims to ensure that markets become and remain competitive. This is particularly important in ACP countries where there is often only one or a few major firms in important sectors, so potential abuse of dominant position may be a concern. It is precisely because these countries are prone to abuses of dominant position, whether by domestic or foreign firms, that it is important to establish the institutions to address basic competition policy. The paper reviews general issues regarding the desirability of a competition policy, considering the reasons why some countries are opposed (typically the concern is with including measures relating to competition policy in international agreements rather than with promoting competition *per se*). Although there is little quantitative evidence on the benefits of a competition policy, there is evidence on the incidence of anti-competitive practices in SSA countries (the only ACP countries for which good documentation is available). As anti-competitive practices are quite widespread, it can be inferred that they impose costs, so implementing competition policy would provide benefits that may, in economic welfare terms, be quite large. Section 3 discusses the main issues to address in establishing a competition policy.

There are many policy options that can increase competition in the domestic market – deregulation, trade liberalization and other market opening policies are examples. The trade reforms inherent in EPAs and the associated moves towards greater regional integration will promote increased competition. Competition policy may then be seen as the institutional mechanism to ensure that markets remain accessible and contestable, and the Competition Authority is its organizational counterpart. As it is desirable to promote and regulate competition, there are benefits to be had from establishing some level of competition policy in ACP countries. While competition policy can be implemented effectively at the country level, and indeed the focus at least initially should be on the national level, given the prevalence of trade, foreign investment and integration it is evident that regional cooperation and coordination is important. Whilst it may be inappropriate for EPAs to act as drivers of competition

policy, they can support the process, especially the regional dimension. By including (minimal) commitments in this regard, EPAs can support the establishment of effective Competition Authorities, and there is evidence that once established Competition Authorities gain acceptance.

The second part of the paper reviews the (economic) literature on increasing transparency and opening up procurement and outlines the main potential sources of welfare gains. In recent years many developed and developing countries, although few ACP countries, have undertaken reforms of their national procurement systems to promote transparency and have reached agreements opening up their procurement market to international competition. These reforms are aimed at ensuring that public funds are used in the most efficient way with greater transparency, probity and accountability so that the system delivers value for money. Studies on the effect of reforming procurement provide evidence that competitive and transparent procurement processes help public authorities acquire better quality goods and services at lower costs. It is essential to include transparency provisions to ensure that the opening up of procurement is effective.

The advantages for most developing, especially ACP, countries in opening up procurement to international competition are domestic (gains from access to other countries' markets are unlikely to be significant): open and transparent procurement encourages competition that is likely to bring gains in terms of lower cost provision of public goods and services and reduced corruption. Gains could also occur in terms of regional integration by giving to ACP firms the possibility to access other ACP countries' markets (provided that procurement is open at a multilateral level towards all EPA countries or within EPA regions). In this way, regional integration provides a rationale for regional procurement policies, and as this has implications for competition it is associated with regional competition policy. In the context of EPAs, easier market access for the EU and greater integration will encourage foreign and domestic investment (Morrissey, 2008), while measures to improve trade facilitation support competition and investment (Milner *et al*, 2008). Thus, EPAs are likely to increase competitiveness and competition in domestic and regional markets, implying a need for (regional) competition policy and facilitating potential gains from more open procurement.

Section 5 addresses the main concerns and problematic issues related to including procurement in international agreements, in particular why developing countries appear opposed to this. While the case for reforming procurement processes is strong, especially for transparency, including commitments in EPAs will be contentious (as for competition policy). It is desirable that any agreement between the EU and ACP on procurement involves the enactment of procurement rules aimed at ensuring transparency and at avoiding discrimination in favour of national suppliers. However, as noted above, most developing countries have opposed any WTO discussions even on transparency in government procurement (they are even more resistant to opening up), and EU proposals encounter the same opposition in EPA negotiations. Proposals could be more attractive for ACP countries if an agreement to insert procurement in EPAs included, together with market access, provisions aimed at enhancing transparency. Transparency alone can provide benefits by reducing corruption and transaction costs. Given that there is limited competition within individual ACP countries (and regions), opening up procurement to foreign providers will increase competition with greater potential benefits through reduced costs. Opening up also increases the rationale for competition policy.

At a practical level, one could envisage procurement being opened up at different speeds in different sectors – the most sensitive being retained for domestic firms and

others being retained for regional firms – whilst introducing broad-based transparency measures. The EU proposal suggests an agreement where ACP countries will open up their procurement markets towards each other (and possibly also towards the EU) with potential benefits for ACP countries in terms of regional integration and new market access opportunities. Moreover, the fear of easy penetration and dominance of EU firms in ACP countries' markets could be overcome by establishing a system which requires EU firms to form joint ventures with ACP firms (this is often the case for EDF-financed contracts). Open and transparent procurement would also function better in the presence of a Competition Policy, especially if this is at a regional level.

However, an agreement aimed at opening up procurement between *all* ACP countries might considerably burden the negotiating process (especially if the EU is to be included). There might be practical difficulties of negotiating in the EPA for one region opening in favour of another region. This is especially so because several EPA regions reject any rules on government procurement; it might be easier to start by limiting any agreement on procurement to one EPA region at a time. Similar concerns apply in the case of Competition Policy. Furthermore, the needs and capabilities of individual ACP countries and regions differ so any regulatory reforms must reflect and accommodate the country context. Whilst it would be inadvisable to propose ambitious or demanding competition or procurement regulatory reforms in EPAs, the liberalization inherent in EPAs and regional integration imply that procurement and competition issues must be addressed.

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