

*Note to readers: As you will see, the paper is very much work in progress. At this stage, I've set out in rough form what I regard as the main building blocks, which require further development and which need to be made more cohesive in the context of the paper as a whole. I am interested in obtaining feedback on what readers might regard as essential, desirable or superfluous to the discussion. Thanks for your consideration and I look forward to your comments. I should add that, unless you are very keen, please feel free to skip or gloss over the material in the annex.*

**“Delivering value for money in government procurement through free trade agreements: a case study of Australia”**

*Tzu-chang asked about government. The Master said, “The art of governing is to keep its affairs before the mind without weariness, and to practice these affairs with undeviating consistency.”*

*- Confucius, Analects XII:14*

## **INTRODUCTION**

Governments purchase a range of goods and services in order to carry out their public service functions. The size of a country's government procurement market depends on a number of factors, including the size of the public sector and overall economy, and the extent to which the government outsources its procurement function. However, in almost all cases government represents a substantial market for goods and services. Estimates of government expenditure as a proportion of gross domestic product in developed countries have been put at between 7-15%, and higher in economies with large public sectors. [Arrowsmith, 2003 at 3; Rojas 2]

As a general proposition, governments of democratic countries have an interest in delivering value for money in procurement. Not to do so might expose them to removal from office in favour of groups better able to manage taxpayer funds and enhance citizens' socio-economic welfare. For present purposes, the term “value for money” refers not necessarily to the acquisition of goods and services at lowest economic cost, but to government achieving maximum benefit from procurement relative to all of the costs involved. Trade considerations aside, a government concerned with delivering value for money in procurement will seek to function more efficiently by attempting to correct, through competitive and transparent procurement processes, at least some of the market failures inherent in its procurement market.

Governments may also improve their capacity to deliver value for money by opening their procurement markets to foreign competition, either unilaterally or by entering into

free trade agreements (FTAs). In theory, this makes a wider range of goods and services available and drives prices below those that would apply in the absence of competition. FTAs also provide governments with an opportunity to enhance market access opportunities for their own exporters in counterparties' procurement markets. These potential benefits may come at the cost of aligning domestic procurement regulation to the terms of the agreements, and through curtailment of governments' ability to use their procurement function to pursue non-economic objectives.

Australia's procurement market is largely open, at least at central government level. Notwithstanding this, Australia has in recent years embarked on a policy of entering into bilateral FTAs to liberalize trade, including in procurement markets, more expeditiously than multilateral processes permit. In this paper, I am interested in exploring the extent to which the government procurement rules Australia has negotiated in its FTAs have furthered Australia's policy objective of delivering value for money in procurement. In my view this involves, at least, a comparison of the potential benefits of increased competition in the Australian Government's procurement market with the costs of adjusting already well developed domestic regulatory structures to comply with, at times, detailed rules negotiated into FTAs that seek to promote non-discrimination in trade. Has the exercise been worthwhile, even accounting for increased market access for Australian exporters in overseas governments' procurement markets?

The discussion may be of value to policymakers seeking to reconcile Australia's domestic interests with the challenges inherent in striking workable bargains with its trading partners. This is particularly the case as Australia vigorously pursues a policy of negotiating FTAs to supplement the process of multilateral trade liberalization.

Part I of this paper introduces the concepts of efficiency and value for money in procurement and explains why, at a domestic level, governments regulate procurement markets to improve the scope for delivery of value for money. Part II places government procurement in the context of international trade, sets out the motivations for countries to negotiate trade agreements relating to procurement and explains the effect these have had on the development of multilateral trade rules. Part III provides an overview of the Australian Government's procurement policy framework. Part IV summarises the government procurement rules Australia has negotiated into its bilateral FTAs, with a focus on market access considerations and the effect of the rules on domestic procurement regulation. Part V draws some preliminary conclusions.

## **I. VALUE FOR MONEY AND MARKET FAILURE IN GOVERNMENT PROCUREMENT**

The importance of government procurement to national economies and the substantial sums of money involved mean that governments use their procurement function to achieve a wide range of economic, social and political objectives. [For a comprehensive discussion, see Trepte, 2005, chapters 2 and 3] A detailed examination of these is beyond the scope of this paper, except to note that achievement of non-economic objectives

represents at once a strong reason for governments to intervene in procurement markets and the principal focus of international trade rules that seek to promote non-discrimination in government procurement. The present discussion will focus on governments' objective of delivering value for money in procurement. This is broader than, but arguably has as its foundation, the concept of economic efficiency. This section focuses on the difference between economic efficiency and value for money, and explains some of the economic reasons why governments regulate procurement markets to enhance their prospects of delivering value for money.

## **1. Efficiency in government procurement markets**

For present purposes, "efficiency" may be defined as allocative efficiency, in the sense of resources being employed for their most productive uses. In an idealized form of perfect competition, this would occur in a government procurement market, like any other market, without government intervention through a process by which market prices send accurate signals to producers and government consumers of the costs and benefits to others of the goods that they produce and consume, respectively. In so doing, producers' and the government's pursuit of their own individual welfare, by comparing the marginal benefit of engaging in procurement activity with the marginal cost of doing so, leads to an optimal "social" level of welfare for the economy as a whole that government intervention cannot improve on. This condition of Pareto optimality means that no alternative allocation of resources can make any economic actor better off without making another worse off. [Deardorff in Bronckers & Quick (eds.) 2000 at 73-74]

## **2. Efficiency and value for money distinguished**

While an economy may be functioning efficiently through a particular allocation of resources, political considerations will determine whether such an allocation is equitable. A primary role of government is to regulate markets to effect the allocation of resources that its political mandate dictates. In this sense, governments can be said to be expressing a value judgement that reflects the will of the majority of its constituents. This is reflected in governments' procurement policies by inclusion of criteria other than pure allocative efficiency in the determination of "value for money". Against this background, value for money in a government procurement context will incorporate decisions by government that seek to pursue policies that may not necessarily result in Pareto efficient outcomes. [Trepte 66-69]

The effect of these considerations on procurement practice is that, in most cases, governments will wish to maintain sufficient flexibility in their procurement policies to enable them to achieve value for money, even at the expense of optimal economic efficiency, if achievement of other policy objectives is considered equally or more important. In practical terms, this may imply governments retaining an element of flexibility and discretion in their procurement decisions, rather than insisting on rigid rules aimed solely at achieving economic efficiency.

As discussed further in part III below, in the Australian context efficiency is a fundamental component of government achieving value for money in procurement, but is not the decisive factor.

### **3. Correction of market failure through competitive tendering procedures and transparency rules**

A Pareto optimal allocation of resources depends on a perfectly functioning, fully informed market. However, there are times when the market will not provide a good or service, or will not provide it optimally, on the basis of the market price mechanism. There are a number of reasons why markets might fail in this sense. In the context of government procurement, the discussion will focus on the market and institutional failures arising from asymmetries of information associated with the identity of the government as consumer. These information asymmetries have significant consequences for (a) competitiveness in government procurement markets and (b) the government's need to delegate its purchasing function to agents. From an economic perspective, they provide governments with their primary incentive for regulating procurement markets.

#### **(a) Imperfect competition**

In a perfectly competitive situation, in which buyers and sellers have no control over market prices, products are standardized, market entry and exit is free and all market participants are fully informed, competition through competitive bidding serves to reflect true costs of production and sets prices accordingly. In a government procurement context, it is not possible for governments, as large public organisations, to observe individual firm behaviour and costs of production. This provides the opportunity for firms to set prices above the level that would prevail in an environment of perfect competition. [Deardorff in Bronckers & Quick, 2000 at 74-76; Mattoo in Hoekman & Mavroidis, 1997 at 62]

Governments can attempt to stimulate competition by establishing competitive tender processes for the award of government contracts. In this way, government compares offers submitted by potential suppliers that are, ideally, unaware of prices offered by each other, and awards contracts to the supplier whose proposal is considered to offer best value for money. [Trepte 112] The potential efficiency gains from attempting to mimic the private in this way provide a strong incentive for governments to unilaterally implement measures in their procurement policies that encourage greater competition between bidders. [Evenett 424]

Open tendering, under which any suitably qualified supplier can submit a bid, is the preferred method of promoting competition. Limited tendering, under which a number of qualified suppliers may be invited to submit bids, and directing contracting, under which a procuring entity may negotiate a contract directly with one or more selected bidders, can also be used in particular circumstances. While limited tendering and direct contracting derogate from open competition, they may nevertheless be the most efficient means of procuring a good or service in some instances. Accordingly, a government that

is interested in delivering value for money will want to reserve the right to conduct procurement according to these methods. [Trepte 118]

**(b) Agency**

[this section draws on Trepte 70-83; 118]

An important effect of the government's identity as an institutional buyer is that it is required to delegate its purchasing function to agents. The interests of government, as principal, and its agents may not be the same and they stand in different relationships to potential suppliers in government procurement markets. The fact that the agent is more closely involved in the procurement process means that he or she will have more information than government about the market and potential suppliers. Agents may exploit these information asymmetries for a number of reasons, most obviously personal gain, thereby undermining the efficiency of procurement markets and raising issues of sanctioning bribery and corruption. These matters may be exacerbated by further information asymmetries as between the government and its suppliers, and between the agent and suppliers.

Governments that wish to minimize the potential for agency problems to affect efficiency in procurement will wish to regulate the manner in which agents are permitted to exercise their functions and discretion. In this sense, regulation is a mechanism for ensuring that the government's agents pursue the government's policy objectives. This typically requires rules that make procurement processes transparent and agents accountable for their actions. Enhancement of transparency in procurement processes can be achieved through a number of mechanisms, including public advertisement of intended procurements to allow maximum competition from suppliers; develop procedures to ensure objectivity in the opening of bids and award of contracts through application of the stated selection criteria, and to have the entire procurement process subject to independent oversight.

As with competitive tendering, the pursuit of value for money in procurement suggests that governments have an interest in unilaterally regulating their procurement markets to limit the exercise of agents' discretion and ensure they are accountable for their actions. However, governments will also wish to ensure that agents' discretion is not fettered to the extent of limiting agents' flexibility to exercise judgment in determining best value for money.

**4. Transactions costs**

Correction of market failures through procurement regulation is costly. The government and its agents will incur costs in establishing structures that seek to mimic the private market, such as orderly tendering procedures, and potential suppliers will incur costs in complying with those structures. In addition, whether transparency rules are beneficial will depend on whether the benefits of the particular rules outweigh their detrimental effects, particularly whether they justify the financial costs of implementation and the

constraints on agents' often legitimate exercise of discretion. [Arrowsmith at 288-293; generally Walker in Hoekman & Mavroidis, 1997 at 179-187]

Arguably, at least in economic terms, it is only when the benefits of regulation exceed its costs that increased regulation is warranted. If governments can achieve value for money in procurement through minimal regulation, they should ask themselves what is to be achieved by promulgating prescriptive rules and procedures that regulate how procurement must be conducted, especially in relation to tendering procedures and transparency obligations.

The analysis is further complicated when countries agree to accept international discipline over their procurement markets. While international trade agreements may hold out the promise of efficiency gains in procurement and increased export market access, the mercantilist philosophy underlying them usually demands a degree of transparency over domestic procurement processes. It is often the case that a government's domestic procurement policy conflicts with its commitments under trade agreements. In these cases, how do governments manage the tension between seeking to ensure value for money in procurement, through greater competition in domestic markets and minimisation of regulatory costs, while simultaneously satisfying their trading partners with sufficiently open and transparent government procurement markets?

The following section outlines why countries might seek to deliver better value for money by liberalising government procurement markets through the mechanism of trade agreements, and briefly outlines multilateral approaches to promotion of non-discrimination in government procurement.

## **II. GOVERNMENT PROCUREMENT IN MULTILATERAL TRADE AGREEMENTS**

Abstracting from the domestic sphere, the principal benefits to a country of signing a free trade agreement relating to government procurement are twofold. First, as a result of the non-discrimination and transparency requirements negotiated into these agreements and increased competition from foreign suppliers, governments have the potential to deliver better value for money to the taxpaying public. Second, governments can achieve improved market access for exporters in their counterparties' procurement markets. These potential benefits come at the cost of adjusting domestic regulatory structures to comply with the terms negotiated into the trade agreements. It follows that in deciding whether to agree to "internationalisation" of their procurement markets, governments need to consider the potential benefits of increased transparency in procurement processes and non-discrimination in the purchase of goods and services. [Evenett 425]

### **1. Why free trade?**

According to established economic theory, countries stand to gain by specializing in the production of goods that they can produce with relative efficiency and trading them for

different goods produced elsewhere. Conduct of free trade according to comparative advantage maximizes global welfare by ensuring first, that resources are employed in the most productive ways and second, that goods produced in each country are distributed in a manner that makes all countries better off in aggregate. [Miles and Scott, 2002 at 205-206; Caves, Frankel Jones, 1993 at 33-37] These considerations suggest that, from the perspective of the international economy, governments' adoption of policies that discriminate against foreign suppliers in domestic markets, including in governments' own procurement markets, results in a shift away from an optimal position of productive and distributive efficiency.

## **2. Effect of protectionist procurement policies**

The economic benefits of non-discrimination in procurement notwithstanding, the scale of government procurement and the political nature of government mean that governments often use their procurement function as a tool to further a range of political, social and economic objectives. These typically include a desire to support domestic industry of a particular type, such as small and medium-sized enterprises (SMEs) and minority-owned businesses, and to protect defence and national security interests. Discriminatory government procurement policies take a number of forms, both explicit and "hidden". [Trebilcock & Howse 2001 at 199]<sup>1</sup>

Governments' use of mechanisms such as these to further secondary policy objectives can have a real effect on limiting competition in domestic government procurement markets, and may also bias private sector incentives against sourcing inputs from foreign suppliers. [Hoekman in Hoekman & Mavroidis at 1; Evenett 421] From the perspective of the international economy, global welfare is likely to be reduced in a situation where governments pursue procurement policies that favour higher cost domestic suppliers over more competitive foreign suppliers, in contrast to an environment in which governments

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<sup>1</sup> Examples of overt discrimination include [Trebilcock & Howse 199-200]:

- a. Domestic preference margins applied against foreign bids, so that a foreign bid may only be accepted if it is a certain percentage below the lowest domestic bid.
- b. Discounts for the domestic portion of a bid.
- c. Procuring goods or services in such a manner that only domestic firms are only invited to bid for contracts, or limiting certain procurements to domestic industries only. This is common in defence procurement.
- d. Set-asides of procurements to specific domestic sectors.
- e. Requiring foreign bidders to incorporate a minimum domestic content as a condition of contract award.

Less direct forms of discrimination include:

- a. Tendering procedures that limit or prevent competition from foreign suppliers, including by selecting the time and method of giving notice of tender solicitations to favour domestic suppliers, and imposing deadlines that foreign bidders cannot meet.
- b. Imposing requirements relating to the good or service the subject of the procurement that are difficult for foreign bidders to meet.

agree to refrain from such discrimination, or at least to place limits on permitted discrimination.<sup>2</sup>

Discrimination in favour of domestic suppliers through procurement policies has the additional feature of being less transparent than other measures to help those industries. For example, the economic effect of directly subsidizing a particular industry may be much more easily quantifiable than a discriminatory procurement policy, as the latter may involve more opaque considerations of agents' discretion and, corruption. [Weiss 16]

### **3. International discipline**

There are a number of reasons why many governments, especially of developed countries, have in recent decades accepted a degree of international discipline over their domestic procurement policies. [Jackson, 1997 at 225; Evenett 417] A principal reason has been increased budgetary pressures faced by these governments, and the resultant imperative to either raise taxes or tighten spending. Liberalising government procurement markets to make them more competitive, especially by opening them to foreign supply, has been considered an attractive means of helping governments to reduce non-welfare spending. Internationalising the process also has the political benefit of dividing domestic vested interests that oppose unilateral reform. [Evenett 424]

Most relevantly for present purposes are the opportunities that may become available to domestic industries to compete internationally through liberalization of the procurement markets of their governments' trading partners. This is arguably the principal reason for governments to enter into trade agreements.

The potential benefits notwithstanding, reconciling a country's domestic procurement system (especially if that is in itself multi-faceted, such as in a federal system of government) with a supra-national system such as that agreed to in a free trade agreement can be challenging. In most cases, it will involve adjustment of the domestic system to meet international commitments. A risk inherent in imposing international procurement rules in the domestic sphere is that those rules are imposed without a full consideration or understanding of the objectives and instruments of the domestic regulation. [Trepte 40] Put another way, countries' desire to secure non-discriminatory market access for their exporters, and perhaps even to enhance the broader bilateral relationship, may cause the practical nature of the domestic procurement system to be overlooked. In some cases, this phenomenon may go so far as to deprive governments of the instruments they require

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<sup>2</sup> Governments' industrial and social policy objectives may be better met by targeting the relevant issue at its source, for example through directly subsidizing particular industries, than by attempting to meet those objectives indirectly through procurement policy. [Hoekman in Hoekman & Mavroidis at 1-2] However, any move away from entrenched protection of particular industries is like to meet resistance from vested interests, even if the means used to protect the relevant interests is not economically optimal. While a discussion of political economy of protectionism in procurement is beyond the scope of this paper, it is noted as a key factor in the formulation of domestic procurement policy and governments' approaches to multilateral negotiations on procurement.

to achieve efficiency and value for money in procurement. Applying international rules in a domestic market that is relatively free of procurement regulation may require governments to adjust their domestic regulatory infrastructure to comply with the rules, or even to establish new infrastructure.

#### **4. Multilateral government procurement rules**

As might be expected, the international rules that have developed in respect of government procurement are framed with mercantilist objectives in mind. This has led to a focus on securing maximum export market access for countries' goods and services, underscored by procedural transparency in the procurement rules.

Governments of developed countries began discussing liberalization of government procurement markets in the OECD in the 1960s, which ultimately led to negotiation of a multilateral agreement on government procurement during the GATT Tokyo Round. Previously, the General Agreement on Tariffs and Trade had explicitly exempted government procurement from the national treatment obligation.<sup>3</sup> [Lowenfeld 2002 at 83-86. See Blank and Marceau in Hoekman & Mavroidis for a detailed exposition of the history of multilateral trade negotiations on procurement.]

The Tokyo Round Agreement – or Code - on Government Procurement (Code) sought to liberalise government procurement markets by establishing an agreed framework for governments' regulations, procedures and practices regarding their procurement. The Code's primary mechanism for achieving this was through the creation of a detailed set of tendering procedures, which incorporated a preference for open tendering, [Trebilcock & Howse at 200]

In spite of being a first step towards multilateral liberalization of government procurement markets, the Code was relatively limited in its ambit. Its provisions applied only to contracts for the purchase of goods, not services, and only to contracts of a value above a certain minimum threshold. Participation was limited to a small number of signatories, mainly developed countries, and only certain "positively" listed central government agencies of those signatories were subject to its provisions. The Code did not apply to sub-central government entities. The limited number of Code signatories also meant the formulation of rules of origin to distinguish between goods emanating from signatory and non-signatory states. Foreign suppliers were still required to pay customs duties on goods entering a signatory state, and signatory governments were permitted to impose offsets, such as local content and licensing requirements, on foreign bidders as a condition of contract award. [Trebilcock & Howse at 200]

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<sup>3</sup> GATT Article III(8)(a) exempts purchases by "[...] government agencies of products purchased for governmental purposes and not with a view to commercial resale."

The Uruguay Round of multilateral trade negotiations resulted in a re-examination and revision of the Code's provisions.<sup>4</sup> The plurilateral Agreement on Government Procurement (GPA) concluded during the Uruguay Round resulted in an extension of the Code's provisions in four principal areas. First, the GPA applies to service and construction contracts as well as contracts for the sale of goods. Second, sub-central government entities and public utilities are brought within the scope of the Agreement. Third, governments (at least of developed countries) may not use offsets as a condition of contract award. Finally, parties to the GPA are required to establish a bid challenge system, under which aggrieved suppliers are entitled to challenge alleged breaches of the GPA before national review bodies.

Nonetheless, the GPA retains many of the features of the Tokyo Round Code. Among these are the positive list approach to coverage of procuring entities, minimum value thresholds for covered procurement and prescriptive administrative procedures in relation to tendering. Most notably, the GPA essentially remains a voluntary agreement with a limited number of signatories, mainly developed countries.<sup>5</sup>

The mercantilist approach to liberalisation embodied in the GPA is reflected in the agreement's approach to coverage, under which parties have agreed to exchange concessions, with the effect that not all parties are bound by the agreement's terms and so the agreement does not span all procurement. This means a greater or lesser degree of exception to the fundamental principle of non-discrimination on which the agreement is predicated. From the perspective of small and developing countries, this "positive list" approach to entity and sectoral coverage makes negotiation of concessions from larger counterparties difficult, in that those countries may not be able to offer much in comparison with their larger counterparties. [Hoekman and Mavroidis in Hoekman & Mavroidis at 300] An alternative path to liberalisation would be to adopt an unconditional most favoured nation approach to coverage. That is, all entities and sectors are covered by the agreement's provisions unless expressed not to be. [Hoekman and Mavroidis at 302]

In terms of transparency in procurement processes, the GPA's feature of setting forth detailed "positive" rules with which GPA parties agree to comply is noted. These rules require parties to conform their domestic rules to the GPA's provisions. This approach may be distinguished from a "negative" approach, which requires parties to comply with an agreement's provisions, but leaves it to the parties to decide how that should occur. A clear effect of positive, prescriptive rules is to limit domestic discretion in the way procurement is conducted. From a mercantilist perspective, this is desirable in reducing the scope for discriminatory procurement decisions in the guise of the exercise of procurement agents' discretion. [Linarelli in Arrowsmith & Trybus, 2001 at 236-237]

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<sup>4</sup> Notably, the process was informed to a considerable extent by the government procurement rules negotiated into the North American Free Trade Agreement. [See Hart and Sauve in Hoekman & Mavroidis at 216]

<sup>5</sup> The current parties are Canada, the European Communities (including its 25 Member States), Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, Netherlands with respect to Aruba, Norway, Singapore, Switzerland and the United States.

However, if too prescriptive, such rules may also have the effect of overly restricting the ability of agents to carry out their functions.

The relatively small number of parties, as well as the limitations in scope and coverage of the GPA, mean that it can be considered only a modest step towards true multilateral liberalization of government procurement markets.<sup>6</sup>

As the World Trade Organisation's most recent trade policy review of Australia notes, Australia remains the only major industrialised country not to have signed the GPA.<sup>7</sup> [WT/IPR/S/104 2002] Rather, Australia is assessing the benefits of the GPA's market access provisions and the potential efficiency gains from increased foreign competition in domestic procurement, with the costs of limiting government flexibility in the use of procurement for certain industry development purposes, together with the costs of complying with the GPA's provisions. Signing the GPA would also expose Australian State and Territory governments to the obligations contained in the GPA. To date those governments have expressed a preference for maintaining independence over their procurement policies and practices.

### **III. AUSTRALIA – COMMONWEALTH PROCUREMENT POLICY FRAMEWORK**

#### **1. Overview**

Australia is a federation, with a central – or Commonwealth – government and six State and two Territory governments. There is an additional tier of local government. Procurement is conducted according to different rules and regulations at Commonwealth, State and Territory level, and there is no national regulation of procurement by sub-national governments and their agencies. For present purposes, the terms “Government”, “Australian Government” and “Commonwealth Government” refer to the Government of the Commonwealth of Australia.<sup>8</sup>

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<sup>6</sup> The success of any attempt to liberalise government procurement markets also depends crucially on removal of barriers to trade that affect the performance of procurement contracts. For example, opening a procurement market to competition will not of itself facilitate greater supplier entry into the market without the simultaneous removal of border barriers to trade in goods, and regulatory restrictions to trade in services. For example, liberalization of a country's construction services market will have a limited effect on competition if workers and materials are not allowed to move freely across borders, into the market. [Rojas 4]

<sup>7</sup> Australia is an observer government.

<sup>8</sup> I have not sought to address State and Territory procurement policy and practice at this stage.

According to the Australian Department of Finance and Administration (Finance), Australian Government contracts gazetted in the 2004-2005 financial year amounted to some A\$23.4 billion across the primary, manufacturing and services sectors.<sup>9</sup>

Australian Government procurement is substantially decentralized, with each agency and its chief executive responsible for that agency's own procurement within the Government's overall procurement policy framework. The three key elements of the framework, which applies to Commonwealth Government departments and agencies, are the Commonwealth Procurement Guidelines (CPGs), issued by the Minister for Finance and Administration, which establish the procurement policy framework for agencies; Finance Circulars, issued by Finance, which advise of changes and developments in the Government's procurement policy framework and other guidance documents published by Finance on an ad hoc basis to assist agencies and officials to implement the Government's procurement policy. [Refer generally CPGs]

## **2. Commonwealth Procurement Guidelines**

### **(a) Application**

The CPGs set out the procurement policy framework for Commonwealth departments and agencies (together, "agencies") and their officials that are subject to the *Financial Management and Accountability Act 1997* (Cth) (FMA Act). The CPGs also apply to Commonwealth authorities and companies listed in the *Commonwealth Authorities and Companies Regulations 1997* (CAC Regulations), as subject to section 47A of the *Commonwealth Authorities and Companies Act 1997* (Cth) (CAC Act), that are directed by the Minister to apply the CPGs.

Agencies and relevant CAC Act bodies are obliged to operate within the framework set out in the CPGs when determining their own procurement practices. The CPGs are expressly stated to apply to all matters relating to the procurement of property or services, regardless of whether those matters are specifically set out in the CPGs. [CPGs at 10] The CPGs contain a mixture of mandatory provisions, and those that reflect good procurement practice.

The Minister for Finance issued an extensively revised version of the CPGs in January 2005, to coincide with entry into force of the Australia-United States Free Trade Agreement (AUSFTA). There was no transition period for implementation, and agencies were expected to be fully compliant with the revised CPGs as at their effective date of 1 January 2005.

The substantive procedural obligations of Chapter 15 of the AUSFTA in relation to tendering have been transposed into Division 8 (Mandatory Procurement Procedures) of the CPGs. As discussed in the section on implementation of the AUSFTA below, these

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<sup>9</sup> [www.finance.gov.au/ctc/contract\\_statistics.html](http://www.finance.gov.au/ctc/contract_statistics.html). This figure does not represent actual expenditure, but provides an indication of the value of Australian Government contracts reported to authorities during the reporting period.

add a substantial new layer of administrative regulation to existing Commonwealth procurement practice, and have had a significant effect on how agencies approach their procurement functions.

**(b) Nature of procurement and non-discrimination in Australian Government procurement**

Procurement is taken to encompass the entire process of acquiring property or services, from initial identification of need through risk assessment, seeking and evaluating alternative solutions, contract award, delivery of and payment for property or services and ongoing contract management, monitoring and assessment. An agency's procurement function includes acquiring property or services for other agencies or third parties.

The Australian Government is committed to a non-discriminatory procurement policy, according to which all potential suppliers are accorded the same opportunities to compete for Commonwealth Government business. [CPGs 5.2] Australia does not generally apply price preference margins, set-asides or offsets in respect of Commonwealth Government procurement. However, the Government is committed to sourcing at least 10% by value of its purchases from SMEs, with the effect that agencies must purchase at least 10% of their requirements from this sector (p 19). The rationale for such treatment is to ensure that SMEs are not unfairly disadvantaged in the market place [WTO trade policies review, 1998 at 90].

**(c) Value for money**

Value for money is expressed to be the core principle underlying Commonwealth Government procurement. Achieving value for money does not necessarily mean purchasing property or services at the lowest price, but is based on an assessment of all relevant costs and benefits associated with a proposal, throughout the life of the procurement cycle.

Value for money in procurement is enhanced by:

- (i) encouraging competition through ensuring non-discriminatory and competitive procurement procedures;
- (ii) promoting an efficient, effective and ethical use of resources;
- (iii) and making decisions in an accountable and transparent manner.

Arguably, a key factor in delivering value for money through efficient procurement is enabling each government agency to reach its own decisions about what represents best value in the context of a particular procurement. This recognises that no single purchasing method suits all situations. Prior to entry into force of the AUSFTA, this concept was reflected in Australian Government procurement policy by according

agencies discretion to select the most appropriate procurement method for the purposes of any given procurement. [WT/IPR/S/104]

Previously, there was also no financial threshold for the advertisement of procurement opportunities. Rather, agencies were responsible for determining the circumstances under which advertising was warranted. Gazetting of opportunities was not required in circumstances where the procuring agency decided to procure products or services from a single source, or from one of a previously established limited field of potential suppliers. However, to encourage transparency in procurement, whichever form of procurement method was selected, details of contracts awarded were required to be gazetted, where their value exceeded minimum thresholds. [WTO trade policies review]

**(d) Enhancement of efficiency through transparency in procurement**

The Australian Government seeks to enhance efficiency in procurement by conducting transparent, fair and appropriately competitive procurements of a scale commensurate with the size and risk profile of any particular purchase. [CPGs 6.4] A direct link is made between accountability and transparency in procurement, and the efficient, effective and ethical use of Commonwealth resources that form a component of value for money. In practice, this means that agencies and their officials are responsible for ensuring that procurement takes place in an open and transparent manner and that decisions are justified. [CPGs 7.1] The CPGs set out the fundamental elements of accountability and transparency as being policy and legislative obligations and documentation and disclosure of procurement processes.

**IV. GOVERNMENT PROCUREMENT IN AUSTRALIA'S FREE TRADE AGREEMENTS**

This section outlines the government procurement rules Australia has negotiated into the four FTAs it is party to. The aim is not to provide a detailed exposition of the rules, but to highlight the basic approach to negotiation of each agreement, with particular attention to market access and transparency obligations, and the effect that the different approaches have had on procurement regulation in Australia.

The agreements are set out in chronological order.

**1. ANZCERTA**

**(a) Overview**

The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) was signed in December 1982 and came into effect in January of the following year. Since the agreement took effect, bilateral trade between Australia and New Zealand has expanded at an annual growth rate of 10%, and two-way investment is estimated to have increased at an annual average rate of more than 18%.

[[www.fta.gov.au/default.aspx?FolderID=283&ArticleID=229](http://www.fta.gov.au/default.aspx?FolderID=283&ArticleID=229)] In addition to the progressive removal of barriers to trade in goods and services, ANZCERTA promotes closer economic relations between Australia and New Zealand in a broad range of matters, including the free movement of persons and mutual recognition of standards.

ANZCERTA is underpinned by a network of bilateral arrangements between Australia and New Zealand, including the 1997 Australia New Zealand Government Procurement Agreement (ANZGPA). The first ANZGPA was signed in 1991 to supersede the 1986 National Preference Agreement, under which the governments of Australia agreed to reciprocal non-discriminatory treatment. New Zealand joined the National Preference Agreement in 1989.

The ANZGPA is a short document of some 6 pages, with an emphasis on broad principles of liberalization, as distinct from prescriptive rules and procedures. In addition to rules designed to eliminate discrimination in procurement, the ANZGPA promotes cooperation and consistency in Australian and New Zealand procurement policy in relation to contractual, technical and performance standards and specifications, and simplicity in the application of procurement, practices and procedures.

#### **(b) Non-discrimination and coverage**

Essentially, the ANZGPA's aim is to create and maintain a single government procurement market in Australia and New Zealand, in order to maximize trade opportunities between the two countries, and maximize business efficiency for both government and industry. The agreement provides Australian and New Zealand suppliers with access to the government procurement market of the other country on an equal value for money footing. Value for money is emphasized as the primary determinant in all procurement decisions, regardless of the method of procurement used (for example, purchase, rental, lease, outsourcing or exchange).

The ANZGPA's national treatment provision [Article 2(c)] requires all government bodies in Australia and New Zealand, including Australian State and Territory Governments (each, a Party) to provide to services, goods and suppliers of the other Parties equal opportunity and treatment no less favourable than that afforded to their domestic services, goods and suppliers. Article 2(d) obliges the Parties to promote opportunities for Australian and New Zealand suppliers to compete for government business on the basis of value for money, and also to avoid purchasing practices that are biased in favour of foreign goods and suppliers. Any form of procurement practice that discriminates against, is biased against, or has the effect of denying equal access or opportunity to any Australian or New Zealand supplier is not permitted (Article 4). This does not prevent any Party from developing new purchasing policy, or from using purchasing policy to implement other policies, so long as doing so does not result in discrimination on the basis of place of origin or the relevant Party's contravention of its commitments under domestic and international government procurement agreements. [Article 5]

In contrast to a positive list approach to entities covered by the terms of the ANZGPA, the agreement is deemed to apply to all Parties, unless an exemption is formally applied for and granted. [Articles 2(b) and 7]

A limited number of exemptions from coverage exist, but these are limited to certain types of procuring entity<sup>10</sup> and certain classes of procurement.<sup>11</sup> Article 9 of Annexure 1 exempts procurement undertaken by parties in accordance with specific policies of a non-procurement nature from the obligations of ANZGPA, but does not specify what these are. Procurement in accordance with social justice and environmental policies are given as examples.

### **(c) Transparency**

In terms of procedures, the Parties agree to achieve maximum practicable simplicity and consistency in the application of procurement policies, practices and procedures. [Article 2(f)] The ANZGPA is remarkably short on administrative procedures to assist procurement officials to comply with the obligations set out in the agreement. Rather, guidelines may be drafted by the APCC to assist procuring bodies and other interested bodies. [Article 13]

Monitoring of Parties' compliance with the terms of the ANZGPA is undertaken by bodies designated by the Parties for this purpose [Article 11] in accordance with the procedures outlined in Annexe 2. This sets out a procedure for dealing with complaints arising out of the ANZGPA, beginning with referral of a complaint to a body designated by each Party for this purpose, examination of the complaint by the Designated Body, including the delivery of a written report to the corresponding designated body in the complainant's jurisdiction and, if necessary, referral to the Minister responsible for procurement in the jurisdiction where the procuring authority is located.

The Australasian Procurement and Construction Council (APCC) is required to report annually to the Parties' respective Ministers responsible for procurement, in respect of both implementation of the ANZGPA, and achievement of its objectives.

### **(d) Effects**

In taking a holistic approach to non-discrimination in government procurement, and through minimal regulation, the ANZGPA has helped underpin a free trade relationship that is widely regarded as one of the most open and successful in the world. It has done so without the imposition of prescriptive rules and procedures, but rather through combining linkage of liberalization of government procurement markets to removal of

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<sup>10</sup> Specifically, entities that trade in substantial competition with the private sector; joint bodies with other governments not party to the ANZGPA and bodies funded primarily from special levies on particular industries, or community groups or from special grants or public donations. [Annexe 1, paras 1-3]

<sup>11</sup> Parties' internal procurement of goods and services from their own departments where no external suppliers have been requested to tender; urgent procurement in cases of emergency; procurement of certain equipment of a work, health or safety nature and procurement for reasons of defence or national security. [Annexe 1, paras 4-8]

barriers to trade in other sectors, as well as close cooperation between the governments of the two countries in ongoing implementation of the agreement's provisions.

## **2. SAFTA**

### **(a) Overview**

The Singapore-Australia Free Trade Agreement (SAFTA) came into effect on 28 July 2003. It encompasses rules to liberalise bilateral trade in goods and services between Singapore and Australia as well as to enhance cooperation in such matters as telecommunications regulation, competition policy, investment, electronic commerce and intellectual property, among others. Chapter 6 of the agreement deals with government procurement.

### **(b) Non-discrimination and coverage**

The national treatment obligation requires that each Party treat goods, services and suppliers from the other country on no less favourable terms than those accorded to domestic goods, services and suppliers when bidding for government contracts. [Article 3]

Chapter 6 takes a positive list approach to entities covered by the Chapter's provisions. In the case of Australia, these are limited to Commonwealth Government departments and agencies (Annex 3A). State and Territory governments are not covered by the provisions, though Australia has undertaken to encourage those governments to list their entities. Annex 3B lists Singapore Government entities covered by the chapter's provisions.

### **(c) Transparency**

SAFTA does not so much prescribe tendering procedures as set out principles for the use of open and limited tendering. [Article 6] The parties' broad obligation in relation to tendering is to ensure that the tendering procedures of its entities are consistent with the provisions of the Chapter, provide for mechanisms to address corruption on the part of procurement officials and suppliers, achieve value for money and are conducted in a fair and non-discriminatory manner. Apart from this obligation, there are minimum standards with respect to publication of tenders and time limits, without prescribing exactly what these should be.<sup>12</sup> Tender evaluation processes are required to be fair and non-discriminatory, and to contain mechanisms to deal with possible conflicts of interest between procurement officials and potential suppliers. Procuring entities are also required to debrief unsuccessful tenderers on the reasons for rejection of their tenders.

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<sup>12</sup> An innovation of SAFTA is its promotion of electronic procurement as a means of facilitating the procurement process, by encouraging the use of procurement by electronic means, wherever possible. [Article 11]

Similarly, there are no mandatory rules and procedures that Parties must comply with to ensure transparency in procurement procedures. Rather, the parties undertake to apply procurement laws, regulations, practices and procedures consistently, fairly and equitably to afford transparency to potential suppliers. [Article 13]

**(d) Effects**

The government procurement rules of SAFTA were negotiated to achieve broad consistency with pre-existing Australian Government procurement policy. Consequently, while SAFTA has created new legal requirements that Australian Government officials must comply with (particularly a national treatment obligation with respect to Singaporean goods, services and suppliers), it has not resulted in wholesale changes to the manner in which procurement is conducted at Commonwealth Government level. In practical terms, the principal new obligations that Australia Government officials need to comply with relate to the handling of confidential information and certain assistance offered to SMEs and indigenous persons in government procurement. However, the chapter does not curtail the ability of the Australian Government, through its procurement agents, to continue to provide that assistance. Nor does it prevent either country's government from pursuing a range of other policies, provided they do not result in a competitive advantage or are applied in an arbitrary or discriminatory manner or as a disguised restriction on trade. [See further DOFA procurement circular PC03/2]

According to the Australian Government, SAFTA has had a significant effect on promoting closer economic integration between Singapore and Australia. Bilateral trade between the two countries increased from A\$12.4 billion to A\$14.4 billion in the year following SAFTA's implementation. Further, of the 450 Australian companies that have done business in Singapore since SAFTA took effect, 208 were new exporters. [DFAT 23 August 2005 press release]

**3. TAFTA**

The Thailand-Australia Free Trade Agreement (TAFTA) entered into force on 1 January 2005. At the time of the Agreement's entry into force, the government procurement chapter contained only a broad acknowledgement by the parties of the importance of government procurement to their economies, and of the desirability of entering into a comprehensive government procurement agreement in due course. [Art 1501] A working group with responsibility for government procurement matters was established, and mandated to meet regularly to discuss relevant issues and make recommendations to the TAFTA Joint Commission on how best to commence bilateral negotiations on the subject. [Art 1503]

Pending the commencement of negotiations, the parties agreed, to the extent possible, to promote and apply transparency, value for money, open and effective competition, fair dealing, accountability and due process, and non-discrimination in their government procurement procedures. As far as Australian Government's procurement policy is concerned, these obligations do no more than reflect current practice and it remains to be

seen whether a future government procurement agreement with Thailand will result in substantial market access or efficiency gains for Australia, or result in substantial changes to domestic procurement regulation.

Negotiations on the development of a TAFTA government procurement chapter are scheduled to commence early in 2006. [DFAT 1 December 2005 press release]

#### **4. AUSFTA**

##### **(a) Overview**

The AUSFTA marks the highest profile FTA to which the Australian Government has committed Australia to date. It is a comprehensive FTA that seeks to promote closer economic ties between Australia and the United States through a comprehensive trade liberalisation agenda. The provisions of the AUSFTA took effect on 1 January 2005.

Chapter 15 of the AUSFTA deals with government procurement. It is comprised of 15 Articles, eight Annexes and a side letter dealing with the Australian Government's procurement of blood plasma. "Government procurement" is defined in Chapter 1 as:

"the process by which a government obtains the use 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[.]" [Article 1.2.13]

##### **(b) Non-discrimination and coverage**

The main objective of Chapter 15 is to promote non-discrimination in government procurement. The Chapter's national treatment obligation requires each Party to afford the suppliers, goods and services of the other the same treatment that applies to domestic suppliers, goods and services. Local preference arrangements, including price preferences, are banned in procurements for which the Chapter applies. [Article 15.2.1 and 15.2.2] Offsets, broadly defined to cover any requirement built into a procurement such as local content, technology transfer or export performance, are also prohibited. [Article 15.2.5]

Chapter 15 takes a positive list approach to entity and sector coverage. In the case of Australia, all agencies subject to the FMA Act are covered by the Chapter's provisions. In addition, Australia has agreed to list a number of entities subject to the CAC Act as being subject to the provisions. As discussed further below, this has subjected some agencies to comprehensive procurement regulation for the first time.

A significant development in relation to coverage as far as Australia is concerned is the agreement of Australian States and Territories to subject a substantial number of their entities to the provisions of the Chapter, with some exceptions in relation to the entities covered and the extent of coverage. This is particularly notable insofar as a principal

reason for Australia's failure to sign the multilateral GPA to date has been the reluctance of the Australian States and Territories to do so. Accordingly, their agreement to the government procurement provisions of the AUSFTA means they become subject to, arguably, a GPA-style agreement, at least in regulatory terms. From a U.S. perspective, not all States have agreed to subject their procurement markets to the disciplines of the Chapter and of those that have, entity coverage varies widely.

The provisions of the Chapter apply only to procurements above certain value thresholds. Thresholds vary for different types of entities and in respect of the supply of goods and services and construction services. The general goods and services threshold for Commonwealth Government entities is procurement of a value at least equal to A\$81,800. This rises to A\$9,396,000 for procurement of construction services. Entities are not permitted to divide a procurement into smaller procurements for the purposes of avoiding these thresholds.

Apart from the limitations on coverage that arise by virtue of the positive list approach to entities bound by the Chapter and the minimum value thresholds, the provisions of Chapter 15 do not apply to:

- (i) the specific types of procurements set out in Article 15.1(3), which the Parties have agreed will not be bound by the rules;
- (ii) measures taken or maintained by a Party that are necessary to protect:
  - public morals, order or safety;
  - human, animal or plant life or health;
  - intellectual property;or that relate to the goods or services of handicapped persons, or philanthropic or not for profit institutions, or of prison labour.
- (iii) exclusions or reservations specific to a country, entity or group or entities that are expressly set out in annexes to Chapter 15;
- (iv) purchases of goods or services for resale or for the production of goods or services for resale;
- (v) certain measures relating to defence and national security interests.

The U.S. has reserved its rights to apply preference policies in respect of small and minority businesses, and Australia has similarly reserved the right to continue to implement procurement policies that assist SMEs and indigenous persons. [Respective country schedules in Annex 15-A]

**(c) Tendering procedures and transparency obligations**

The majority of Chapter 15 is devoted to the detailed rules and procedures each Party agrees to adopt to ensure that procurement takes place in a transparent manner, to promote the overriding objective of non-discrimination. A summary of these is included in the annex to this paper.

The rules take a prescriptive approach to what constitutes “transparency” in procurement processes, especially tendering procedures, and impose a new layer of regulation on Australian Government procuring entities. This may be contrasted with the approach to transparency taken in the ANZGPA and SAFTA, both of which set out minimum standards for transparency in procurement and tendering procedures, but leave it to the parties to determine how to meet those standards.

Broadly, in terms of tendering procedures and in contrast to pre-existing Australian practice, Chapter 15 allows procuring entities to use open, selective or limited tendering procedures only. The rules favour open tendering, with selective and limited tendering only permissible on satisfaction of conditions. These rules effectively remove the discretion previously available to Australian agencies to tailor purchasing methods to particular types of procurement. In addition, new minimum time frames apply in respect of all procurements. While these are designed to give potential suppliers adequate time to respond to requests for tender, they also limit officials’ discretion in carrying out individual purchases and, arguably, remove an element of flexibility from the procurement process.

In terms of transparency in procurement, there are now mandatory minimum standards for public notice of covered entities’ procurement activities. Most notably, these include specific requirements for publication of tender opportunities and in respect of contract awards.

**(d) Potential market access and efficiency gains and effects on Australian Government procurement practice**

From Australia’s perspective, the principal market access gain from the non-discrimination provisions of Chapter 15 is Australia’s inclusion as a designated country under U.S. *Trade Agreements Act*, with the effect that U.S. procurement officials may now consider bids from Australian firms direct, without the need for those firms to establish operations in the U.S., or in a third country, or to establish partnering relationships with U.S. firms. Additionally, the US has agreed to waive Australia from the application of the *Buy America Act*, which imposes a 6% price penalty on foreign goods. As a result, Australian firms may now compete with US firms, and firms from other designated countries, on an equal footing.

These new market access opportunities for Australian firms have been the focus of most of the discussion around the government procurement chapter of the AUSFTA in

Australia. In particular, both government and business view the new market access arrangements as a significant opportunity. The remarks of Australia's lead negotiator in the AUSFTA negotiations are typical of the prevailing Australian sentiment in relation to market access:

“[Government procurement is] an area where work needs to be done to identify what are still the hurdles, what are the opportunities, and how Australian industry can access [U.S. government procurement markets]. That is a big part of the overall gains over time. It is up to Australian industry to first understand the opportunities that have opened up and how Australian industry can go about achieving them.” [Australian Senate Joint Standing Committee on Treaties, June 2004 report on the AUSFTA]

Notwithstanding the new opportunities available to Australian exporter as a result of the AUSFTA, and some “success stories”<sup>13</sup>, economic studies project only modest increases in Australian export sales to the U.S. Government.

A 2004 report prepared for the Australian Government by the Centre for International Economics projected only modest Australian industry penetration of the U.S. Government procurement market under an FTA. The report suggested a likely increase in Australian supply to the U.S. Government of between A\$50 million and \$360 million per annum, or around a 0.1% share of the total U.S. Government procurement market. [CIE, “Economic Analysis of AUSFTA: Impact of the bilateral free trade agreement with the United States”, 2004]

It is also open to question what efficiency gains the Australian Government stands to make in the context of its already open procurement market, as a result of the AUSFTA's rules. These gains may be difficult to measure in practice, at least until the Agreement has been in operation long enough for meaningful statistics to be compiled.

The AUSFTA's potential market access and efficiency gains to Australia must be viewed against the significant impact the Agreement has had on government procurement practice in Australia. In contrast to ANZGPA and SAFTA, the government procurement rules negotiated into the AUSFTA have resulted in substantial modifications to Australian Government procurement regulations. They also significantly affect procurement practice, especially by subjecting many agencies to comprehensive regulation for the first time.

Some of the practical implications of the AUSFTA for Australian Government agencies are that they would have been advised, prior to 1 January 2005, to:

- undertake a comprehensive review of their procurement activities and determine whether they need to be centralised to manage the risk of non-compliance with the new provisions;

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<sup>13</sup> See, for example, [www.efic.gov.au/static/efi/home/news220805.htm](http://www.efic.gov.au/static/efi/home/news220805.htm) and [www.efic.gov.au/static/efi/home/news020905.htm](http://www.efic.gov.au/static/efi/home/news020905.htm).

- train relevant officers about the new requirements, including by highlighting the mandatory, legally-binding nature;
- identify planned procurements and create an annual procurement plan;
- create internal guidelines to ensure compliance with new reporting and record-keeping requirements;
- take steps to document existing contractual arrangements to comply with revised documentation requirements;
- review request for tender documentation to ensure compliance with the AUSFTA's notification requirements and evaluation criteria for the award of contracts;
- in developing tender specifications for inclusion in requests for tender, ensure that these are sufficiently wide and contemplate contingencies so that any reasonable variations to scope during the term of a contract do not constitute a new procurement requiring a new tender process;
- ensure that all reasons for decision in respect of a particular procurement are thoroughly documented, to provide for the increased scope for supplier challenge to procurement decisions; and
- create complying internal procedures to be followed in the event of a supplier complaint.

[Minter Ellison – Procurement implications of the FTA. October 2004]

[Insert EFIC case study, as an example of a CAC Act agency newly subject to comprehensive regulation]

## **VI. PRELIMINARY CONCLUSIONS (AND POSSIBLE AVENUES FOR FURTHER INVESTIGATION)**

The approach to transparency in procurement taken in the AUSFTA is to set out detailed obligations on how entities should undertake procurement, including prescriptive rules in relation to the types of technical specifications and tendering procedures that may be used, information that must be included in tender documentation and contract award procedures. It is open to question what those obligations add to an Australian procurement policy that is already focused on delivering value for money. At the very least, the rules impose a new layer of administrative regulation on the procurement process across each covered entity, which may go so far as to undermine efficiency and the ability of procurement agents to maintain sufficient flexibility in procurement practice. Strict time limits in relation to the receipt of tenders, restrictions on the use of limited tendering and the administrative burden of discharging reporting and record-keeping functions are desirable to the extent that they reflect good business practice. However, insofar as they begin to interfere with the efficient discharge of the procurement function, commensurate with the objective of delivering value for money, it is reasonable to ask what is to be gained by agreeing to such rules in and of themselves, or in return for what may be modest gains in export market access and efficiency in domestic procurement markets. [Walker 181]

The underlying rationale for detailed transparency obligations in procurement processes is for them to assist governments to mimic the private market in their purchasing behaviour. Arguably, the regulatory costs involved can only be justified in cases of actual or anticipated market failure. [Walker 186] Accordingly, it is reasonable to enquire what governments interested in delivering value for money, and with already well developed domestic regulatory structures, might stand to gain by subjecting themselves to international discipline over their procurement markets. It may be that the increased regulatory costs of complying with the rules, together with the potential loss of flexibility in procurement practice, undermine the very goal of value for money that is, in part, sought to be achieved by governments in agreeing trade rules in relation to government procurement.

The Australian experience suggests that government procurement agreements based on broad principles of liberalisation can contribute to strong bilateral trading relationships, including a high degree of non-discrimination – and even cooperation – in government procurement markets. The ANZGPA is the outstanding example of this type of agreement, but SAFTA’s government procurement rules have been drafted in a similarly flexible, non-prescriptive manner. The virtues of this type of approach are its commitment to extension of non-discriminatory market access combined with a relatively “hands off” approach to regulation of markets that are already relatively open.

Australia’s agreement to adopt a more prescriptive set of government procurement rules in the AUSFTA, ostensibly in return for increased access to U.S. government procurement markets, requires an analysis of whether the costs of doing so outweigh the potential benefits. Statistically, it is too early to tell if that is the case. However, economic modelling [and the Canadian experience in its government procurement agreements with the U.S.] suggests that only modest gains in market share may be possible for Australian exporters. This has come at the cost of significant changes to Australia’s own domestic regulatory structures.

In light of the different approaches to government procurement rules Australia has negotiated into its FTAs, a review of the effectiveness of the current agreements may prove instructive in terms of Australia’s future FTAs. Australia is currently negotiating FTAs with the People’s Republic of China, Malaysia, the United Arab Emirates and (with New Zealand) ASEAN. It is also negotiating a Trade and Investment Framework Agreement with Egypt, and conducting studies on how to strengthen economic relations with Japan and Korea. Against this background, it is suggested that Australia should be considering the merits and likely impact of negotiating varying types of government procurement rules with each of these counterparties. An inconsistent approach, or at least one that privileges market access opportunities above the government’s own domestic interests, should be approached with caution. The danger is that a proliferation of different types of rules will only increase the domestic regulatory burden of complying with the rules, at considerable cost.

Canadian experience of negotiating government procurement rules with the U.S. suggest that poor rule-design at regional level is more likely to be replicated at multilateral level. In the Canadian example, specific reference is made to pursuit of a reciprocity-based, positive list and threshold approach to liberalisation. [Hart and Sauve in Hoekman & Mavroidis at 217] This argument could be extended to a regional level, in which poor rule design in one FTA sets a negotiating precedent for the particular government's approach to future trade agreements.

In terms of Australia's policy objective of delivering value for money in procurement, Australia may be able to learn from the Canadian experience by negotiating, to the extent possible, government procurement rules in its future FTAs that allow the Australian Government to maintain maximum flexibility in procurement processes, at minimal cost. In Australia's case, the ANZGPA is perhaps the best – and arguably most successful – example of such an approach to date.

## **Annex**

### **AUSFTA – Summary of transparency requirements and prescribed tender procedures**

#### **Article 15.3: Publication of relevant information**

Each Party is required to publish all laws, regulations, policies, procedures and policy guidelines, as well as judicial decisions and administrative rulings of general application, as well as amendments to that information, in either electronic or paper form that is widely disseminated and publicly available. [Article 15.3]

#### **Article 15.4: Notices of intended procurement**

Procuring entities are required to follow certain procedures in relation to their intended procurements.

Except in limited, prescribed circumstances, procuring entities are required to publish a “notice of intended procurement” (that is, a notice inviting interested suppliers to submit tenders), or where appropriate, applications for participation in a procurement, for each covered procurement. The notice must be published electronically or in paper form, that is widely disseminated and publicly available, for the entire period established for tendering. [Article 15.4.1] A notice of intended procurement must include contact information in respect of the procuring entity, and all relevant documents relating to the procurement; a description of the procurement and any conditions of participation; and the address and time limit for the submission of tenders and, where appropriate, any time limit for the submission of an application for participation in a procurement, and the time frame for delivery of the goods or services the subject of the procurement. [Article 15.4.3] Procuring entities are encouraged, but not obliged, to publish on an annual basis a notice regarding their procurement plans for the forthcoming year, as early as possible in each fiscal year. These “annual procurement plans” are intended to include the subject matter of any planned procurement and the estimated date of the publication of the notice of intended procurement. Special rules apply for publication of notices in situations where a short (less than 30 day) tender period applies. [Article 15.4.3]

#### **Article 15.5: Applicable time frames**

Article 15.5 prescribes time frames within which tenderers may submit tenders. The general purpose of the provision is to ensure that tenderers have adequate time within which to submit applications or requests to participate in a covered procurement, and to prepare and submit tenders, taking into account the nature and complexity of the procurement. [Article 15.5.1] The time frames are, among other things, designed to ensure that tenderers located outside the territory of a Party are not discriminated against with respect to the timing of submission of tenders.

The general rule is that a procuring entity must allow at least 30 days from the date on which the notice of procurement is published, or where selective tendering is used, from the date on which the entity invites suppliers to submit tenders, for the submission of tenders in relation to a covered procurement. [Article 15.5.2]

Exceptions to the general 30-day rule apply in the circumstances listed below, provided that any shorter time limit is sufficiently long to enable suppliers to prepare and submit responsive tenders, and is in any case no shorter than 10 days [Article 15.5.3]:

- (a) where the procuring entity previously published a separate notice, including a notice of planned procurement [cf Article 15.4.3] at least 30 days but no more than 12 months in advance, and that notice contained a description of the procurement, the time limits for the submission of tenders or, where appropriate, applications for participation in a procurement, and the address from which documents relating to the procurement may be obtained;
- (b) where the procuring entity procures commercial goods or services;
- (c) in the case of second or subsequent notices for procurement of a recurring nature; or
- (d) in cases of urgency.

A procuring entity may also reduce the time limit for submission of tenders in cases where it publishes a conforming notice of procurement in electronic form or, in the case of selective tendering, issues an invitation to tender via in electronic form and also provides, to the extent practicable, the tender documentation electronically. However, in all cases a minimum 10-day period for submission of tenders, calculated from the date on which the procuring entity publishes the notice of procurement, applies. [Article 15.5.5]

Where a procuring entity limits the submission of tenders to those that the entity has determined have satisfied any conditions for participation, the entity must include a time limit for submission of tenders in the invitation to tender. This requirement does not apply where a notice of a multi-use list has been readily accessible electronically for a reasonable period. Conditions for participation in a tender must be published sufficiently in advance to enable interested suppliers of the other Party to initiate and, so far as is compatible with efficient operation of the relevant procurement, complete the registration and qualification procedures within the time allowed for tendering. [Article 15.5.5]

All participating suppliers must be required to submit tenders in accordance with a common deadline, including where information provided to potential suppliers during the procurement process necessitates an extension of the time limit for submission of tenders, and where new negotiations permit the submission of new tenders. [Article 15.5.6]

## **15.6: Requirements of tender documentation in relation to intended procurements**

Article 15.6 deals with procuring entities' dissemination of information in relation to intended procurements.

The general rule is that procuring entities must promptly provide, on request, to any supplier participating in a covered procurement, tender documentation that permits suppliers to prepare and submit responsive tenders. Unless already provided in the notice of intended procurement, the information must include the matters listed in Article 15.6.1(a)-(e). These are:

- (a) a complete description of the procurement, including such matters as the nature, scope and, where known, quantity of the goods and services to be procured, as well as any particular requirements to be fulfilled, including technical specifications;
- (b) any conditions for participation, including financial guarantees and any information or documents that suppliers are required to submit;
- (c) all criteria to be provided in the awarding of the procurement contract;
- (d) in cases of public opening of tenders, the date, time and place of that opening; and
- (e) any other terms and conditions relevant to the evaluation of tenders.

Procuring entities are also required to furnish further, relevant information to potential suppliers on request provided that it may not make available information in relation to a specific procurement in a manner that would give a supplier or group of suppliers an advantage over its or their competitors. [Article 15.6.2]

The remainder of Article 15.6 deals with procuring entities' use of technical specifications in covered procurements.

Principally, procuring entities are precluded from preparing, adopting or applying technical specifications, and from prescribing conformity assessment procedures, with the purpose or effect of creating unnecessary obstacles to trade. [Article 15.6.3]

Article 15.6.2 contains guidelines as to how procuring entities prescribe technical specifications for covered procurements. In particular, procuring entities are required to specify technical specifications, where appropriate, in terms of performance and functional requirements, rather than in terms of design or description. The specifications must also be based on international standards where they exist and applicable to the procuring entity, except where use of such a standard would fail to meet the procuring entity's program requirements or would impose greater burdens than the use of a recognized national standard [Article 15.6.4]

Article 15.6.5 mirrors the language of the GPA in banning procuring entities from prescribing technical specifications that require or refer to particular intellectual property, unless there is no other sufficient precise way to describe the procurement requirements and provided that “equivalence” language is included in the tender documentation.

Notably, 15.6.6 proscribes procuring entities from seeking or accepting, in a manner that would have the effect of precluding competition, advice from any person that may have a commercial interest in a particular procurement that may be used in the preparation or adoption of any technical specification for that procurement. However, this provision does not prevent procuring entities from conducting market research in developing specifications for a particular procurement or from allowing a supplier engaged to provide design or consulting services in relation to a procurement to participate in procurements related to such services, provided that to do so would not give the supplier an unfair advantage over other suppliers. [Article 15.6.8]

Finally, where during the course of a covered procurement, a procuring entity modifies criteria or technical specifications or amends or reissues a notice or tender documentation, it is required to disseminate all such modifications or amendments or re-issued notices or tender documentation to all suppliers that are participating at the time of the amendment, if known, and otherwise in the same manner as the original information, allowing sufficient time to allow suppliers to modify and re-submit their initial tenders, if appropriate. [Article 15.6.9]

### **Article 15.7: Tendering procedures**

Procuring entities are required to limit any conditions for participation in a procurement to those that ensure that a supplier has the legal, commercial, technical and financial abilities to fulfil the procurement’s requirement. [Article 15.7.1] In assessing whether a supplier fulfils these conditions, the procuring entity must have regard to that supplier’s business activities both within and outside the territory of the Party of the procuring entity. [Article 15.7.2(a)]. Previous experience of contracting within the territory of a Party may not be used as a criterion for participation [Article 15.7.2(b)], though a procuring entity may require relevant prior experience where that is essential to meet the requirements of the procurement. [Article 15.7.2(d)] The procuring entity must determine whether a supplier has met the conditions for participation solely on the basis of information the procuring entity has published in advance, in notices or in the tender documentation. [Article 15.7.2(c)] A procuring entity will be entitled to exclude a potential supplier on the grounds of such matters as the supplier’s insolvency, fraud or sub-standard performance of a prior contract. [Article 15.7.3]

Article 15.7.4 allows both parties, and their procuring entities, to use multi-use lists on condition that the relevant procuring entities or another government agency of the Party concerned, publishes annually or makes continuously available in electronic form a notice inviting interested suppliers to be included on the list. Such a notice must include a description of the goods and services, or categories of goods and services, for which the list may be used; the conditions for participation and the means the procuring entity will

use to ensure they are satisfied; contact details for the procuring entity and any deadline for submission of applications for inclusion on the list. [Article 15.7.4] Once a procuring entity determines that a supplier has satisfied the conditions for inclusion on the list, it must add the supplier to the list within a reasonably short time. [Article 15.7.5] This term is undefined and presumably what constitutes a “reasonably short time” is to be determined in all the circumstances of a particular case.

While open tendering is the preferred means of approaching potential suppliers, selective tendering is permitted on conditions. In the case of any intended covered procurement where a procuring entity wishes to use selective tendering, that entity must invite tenders from the largest number of domestic suppliers and suppliers of the other Party that is consistent with the efficient operation of the procurement system. [Article 15.7.6] A procuring entity applying selective tendering procedures must use one of the methods listed in Article 15.7.8 to ensure competition in supply. However, in short-listing suppliers to those that will be invited to tender, the procuring entity is entitled to assess the extent to which a supplier’s proposals or responses meet technical and performance specifications of the procurement, and to limit the number of suppliers that it invites to tender, based on the rating of the supplier proposals or responses. [Article 15.7.7] Procuring entities are required to apply the same time limits for submission of suppliers’ submission of applications for participation in a procurement, and suppliers’ expressions of interest, as apply to open tender procedures.

Procuring entities are required to notify a supplier who has applied for participation in a covered procurement, of the procuring entity’s decision with respect to the supplier’s application. [Article 15.7.10] They are also required to give written reasons for rejection of a supplier’s request for participation in a covered procurement or its inclusion on a list, or where the procuring entity ceases to recognize a supplier as having met satisfied the conditions for participation in a procurement. [Article 15.7.11] There is no prescribed form for such statement of reasons.

### **Article 15.8: Limited tendering**

Procuring entities are permitted to dispense with the procedures for open and selective tendering in certain circumstances. These are limited to the situations listed in Article 15.8.1, many of which mirror language used in the GPA. Limited tendering is permitted in such circumstances as when no satisfactory tender was submitted in response to a notice, invitation to participate or invitation to tender; where the goods or services can be supplied only by a particular supplier and no reasonable alternative or substitute exists for one of a list of specified reasons; for additional goods or services furnished by a supplier under a prior contract that are intended as replacements parts, extensions or continuing services; and for new construction services consisting of the repetition of similar construction services that confirm to a basic project for a which an initial contract was awarded following the use of open or selective tendering in accordance with the provisions of Chapter 15. Exceptions also exist to allow procuring entities to purchase goods or services under exceptionally advantageous, short-term conditions, including in response to innovative, unsolicited proposals.

If a procuring entity chooses to purchase goods or services through limited tendering, it must account for its decision by preparing a written statement indicating the circumstances and conditions that justified its doing so.

### **Article 15.9: Treatment of Tenders and Awarding of Contracts**

Article 15.9 imposes a number of obligations on procuring entities in relation to the receipt and opening of tenders, and awarding of contracts, designed to guarantee the fairness, impartiality and confidentiality of procurement processes. Relatively detailed formalities are prescribed for the receipt and opening of tenders [Article 15.9.1-4] and for the awarding of contracts. In the latter case, a procuring entity is only permitted to consider tenders that meet the essential requirements of the relevant procurement, at the time of opening of tenders. [Article 15.9.5] Unless the procuring entity considers it is not in the public interest to do so, the entity must award the contract to the supplier that the entity determines satisfies the criteria for participation and is fully capable of undertaking the contract, and whose tender is determined to be lower price, the best value **or** the most advantageous in accordance with the essential requirements and evaluation criteria specified in notices and tender documentation.

Procuring entities are required to account to unsuccessful tenders as to why their tenders were not successful. [Article 15.9.8] Procuring entities are also required to publish certain prescribed information about the award of contracts, in an officially designated publication, not later than 60 days after the date of contract award. Procuring entities are also required to maintain records of their tendering procedures in relation to a covered procurement, for at least 3 years after the award of the relevant contract. [Article 15.9.11]

At a broader level, on request of a Party, the other Party is required to provide information about the tender and evaluation procedures used in the conduct of a particular procurement, which must be sufficient to demonstrate that the procurement was conducted fairly, impartially and in accordance with the provisions of Chapter 15. Article 15.1.10 provides guidance as to the information a Party is required to furnish to the other Party pursuant to this provision.

### **Article 15.10: Integrity in Procurement Practices**

Parties must ensure that criminal or administrative penalties exist to sanction both procurement officials and other persons who are found to have engaged in corrupt activity in relation to procurement activity.