Third countries' reciprocal access to EU public procurement

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Detailed appraisal
of the European Commission's Impact Assessment

Third countries' reciprocal access to EU public procurement

Commission proposal for a Regulation of the European Parliament and of the Council establishing rules on the access of third country goods and services to the EU's internal market in public procurement and procedures supporting negotiations on access of EU goods and services to the public procurement markets of third countries

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The Research Papers attached have been commissioned, at the request of the European Parliament's **Committee on International Trade** and the **Committee on the Internal Market and Consumer Protection,** by the Ex-ante Impact Assessment Unit of the Directorate for Impact Assessment and European Added Value, within the Directorate General for Parliamentary Research Services (DG EPRS) of the General Secretariat of the European Parliament.

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Introduction

The Ex-ante Impact Assessment Unit of DG Parliamentary Research Services was requested by the INTA and IMCO Committees to provide a detailed analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying the proposal for a Regulation of the European Parliament and of the Council establishing rules on the access of third country goods and services to the European Union's internal market in public procurement and procedures supporting negotiations on of European Union goods and services to the public procurement markets of third countries.

As part of this process, the Unit has commissioned four research papers, drafted by specialist experts, on various aspects of the Commission's IA. They are authored by:

Prof. Dr. Andrea RENDA, CEPS, who addresses the questions put forward by the INTA and IMCO Committees from a methodological point of view.

Mr. Máté Péter VINCZE, MSc in Economics, who deals with the questions put forward by the INTA and IMCO committees, with a view to finding answers substantiated *inter alia* by data-mining in relevant databases.

Dr. Pedro TELLES, Bangor University, UK, who focuses on impacts, thresholds and national legislation in respect to SMEs.

Professor Dr. Nicola DIMITRI, University of Siena, Italy, who analyses reciprocity and retaliation questions, using a game theory approach.

The full texts of these four research papers are attached and are also available at:
http://www.europarl.europa.eu/committees/en/studies.html

The experts were asked to provide an appraisal of the European Commission's impact assessment, analysing, commenting and possibly complementing it with regard to eight topics:

1. Openness of EU public procurement market;
2. Potential benefits of market opening;
3. Impact on job creation of the different options;
4. Risk of retaliation and leverage creation;
5. Administrative burden of assessed options;
6. Impact on SMEs;
7. Justification of thresholds;
8. Existing national legislation restricting access to public procurement markets.

In the terms of reference, a set of specific questions were formulated under these topics. In Chapter II below, the questions posed are set out, with summaries of the replies given by the four experts. Chapter I provides a brief analysis of the strengths and weaknesses of the Commission's IA in general.

Chapter I

Introduction: general strengths and weaknesses of the Commission's IA

• Background

The proposed Regulation lays down rules on the access of third-country goods or services to the award of contracts for the execution of a work, the supply of goods and the provision of services by Union contracting authorities/entities, and establishes procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries.

Currently, the access of third country producers to the EU procurement market – and vice versa – is regulated through a variety of voluntary and negotiated agreements in the context of the WTO's Government Procurement Agreement (GPA) or under specific chapters of various bilateral free trade agreements (FTAs).

• Identification of the issue at stake

Annex 1 to the IA contains a helpful problem tree, in which the Commission sets out the problems in need of EU intervention, their drivers and possible consequences.

The Commission proposal rests on two main arguments: (i) third countries have not committed the same amount of procurement markets in the GPA (Government Procurement Agreement), and as such are less open than the EU, which hampers EU interests in these markets; and (ii) the Commission does not have enough leverage in international negotiations, since – given that it already opened all its markets – there is not much more than the Commission can offer as a 'bargaining chip' to other countries to trigger reciprocal concessions[1]. Moreover, Member States and contracting authorities would feel they lack practical instruments and detailed guidance to understand and cope with the complexity of the EU's international procurement commitments. Several Member States have taken measures to regulate the access by non-EU firms, goods and services to their procurement market, which may be infringing the common commercial policy.

According to the Commission, the identified problems lead to the following negative consequences: (i) EU companies are being deprived of business opportunities abroad, thus reducing their leadership and preventing them from creating economies of scale, (ii)

[1] See for more in-depth analysis and criticism of the Commission's approach, the attached papers by Renda and Vincze.

the exports of companies that bypass domestic measures can be affected at any moment by protectionist measures, (iii) EU jobs are not created and in some cases they are destroyed by the distortions resulting of protectionist measures, (iv) many sectors dependent on public procurement are being forced into technology transfers, further reducing their competitiveness, or to conduct innovative activities abroad, (v) domestic barriers are also preventing the internationalisation of SMEs, (vi) an uneven level playing field for EU firms, and (vii) the EU could face WTO/FTA litigations for not respecting its international obligations.

• Objectives of the legislative proposal

The *general* objectives of the initiative are to increase the competitiveness of EU businesses, both in the EU and internationally, to boost the internationalisation of SMEs in a globalised economy, to increase employment and to promote innovation in the EU.

These general objectives are translated into *specific* and *operational* objectives. Specific objectives include (i) boosting the exports of EU goods and services in public procurement markets outside the EU; (ii) giving the EU greater leverage in international negotiations on procurement; (iii) strengthening the playing field for European companies in the internal market; (iv) improving legal certainty in respect of third countries' access to the EU's public procurement market; (v) ensuring that commitments on public procurement given to the EU as part of its international agreements are respected, and (vi) avoiding breaches of the EU Treaties.

• Range of the options considered

The IA presents and explains in some detail a range of, in total, six options and five sub-options, including the option to maintain the status quo.

Option 1. Baseline scenario – no policy change.

Option 2. Non-legislative approach.

- Option 2A - Soft-law approach, making more use of dispute settlement or infringement procedures;
- Option 2B - Taking a tougher approach of the EU in negotiations on public procurement.

Option 3. Legislative approach: Instruments with supervision by European Commission.
Under this option, the legislative initiative would define and regulate access to public procurement covered and not covered by the EU's international commitments and would establish 'procurement rules of origin' to identify the origin of goods and services.

- Option 3A - Overall access restriction for not covered procurement at the EU level. EU contracting authorities would be required – in principle – to exclude third country goods, services and companies not covered by international commitments of the EU. It would be possible to derogate from this rule, in which case the contracting authority would have to notify the Commission (ex post).
- Option 3B - Individual decisions by the EU procuring entities and a Commission driven mechanism in case of not covered procurement. EU contracting authorities would have the option to exclude non-covered companies, goods or services, subject to notification to the Commission. The Commission would have the option to impose access restrictions.
- Option 3C - Option for contracting entities to accept companies, goods and services not covered by the EU's international commitments, subject to notification of the Commission. The Commission would have the option to impose access to the EU's public procurement market

Option 4. Legislative approach: Instruments without supervision by European Commission.
The existing provisions for utilities (Article 58 of Directive 2004/18/EC) would be extended to the whole scope of the Procurement Directives.

Option 5. Application of price penalties for non-covered goods and services ('Buy Europe').
This option is not further analysed in the IA.

Option 6. Complementary approach: correcting unfair 'abnormally low tenders'.

The Commission's preferred policy option is a combination of Option 3B (individual decisions by EU procurement entities and a Commission driven mechanism), together with Option 6 (mechanism to address abnormally low tenders and Option 2B (continuation of forceful negotiations).

• Scope of the Impact Assessment

For all options, except Option 5, the IA sets out the expected impacts on trade and jobs, on competitiveness, the possible leverage effect vis-à-vis some third countries, impacts on public finances, administrative burdens, on competition and innovation, on consumers, and on the environment. It equally explains the potential for all options to clarify the rules and, therefore, to ensure legal certainty. Annex 4 elaborates on the analysis of these impacts.

- **Subsidiarity / proportionality**

The proposal is based on Article 207 TFEU, providing a basis for the adoption of measures defining the framework for implementing the common commercial policy, an exclusive EU competence. Therefore, the subsidiarity principle does not apply.

According to the Commission's IA Board (second opinion, of 20 February 2012), the analysis and the evidence base supporting the proportionality of the proposed EU action remain weak. The subsequent revision of the impact assessment seems not to have addressed this criticism.

- **Budgetary or public finance implications**

According to the Explanatory Memorandum of the proposal, it does not have budgetary implications; the additional tasks for the Commission could be met with existing resources.

- **SME test**

The IA appears not to analyse sufficiently the impacts of the different options on SMEs. For example, their possible role as local suppliers in bids placed by third country companies in EU procurement markets has not been considered sufficiently. Furthermore, the IA did not consider that administrative burdens and compliance costs (such as certificates of origin) could fall disproportionally on SMEs[2].
The policy options that are linked with larger import replacement (Options 3A and 3C) would be the most beneficial for SMEs[3].

- **Relations with third countries**

The IA analyses the expected impact of the proposal on incentives for third countries to negotiate public procurement with the EU (negotiations leverage) and on the risk of retaliation. For retaliation, the Commission sets out three possible scenarios: 'no retaliation', 'simple retaliation' or 'massive retaliation' (boycott) (IA, Annex 4, p. 3-5). However, the IA does not seem to take into account that third countries affected by the proposed regulation may also decide to retaliate outside the field of public procurement in a more general trade dispute[4].

[2] See the papers by Renda, p.24-25, Telles, p. 11 and Vincze, p. 10.

[3] Paper by Vincze, p. 32/35.

[4] Paper by Telles, p. 10. See also the game theory approach of retaliation, paper by Dimitri.

Whether or not the potential for market opening in third countries and the risk of retaliation are correctly assessed, depends on the correct analysis of the *de facto* openness of EU public procurement and the *de facto* openness of third countries (compared to EU)[5].

- **Quality of data, research and analysis**

Data used in the IA seem to originate mainly from stakeholder consultation and different services within the Commission. The IA contains a methodological Annex 7. However, the IA is being criticised because the models used are not sufficiently described and thus difficult to follow; some of them, e.g. those on job-creation, could not be reproduced, and the calculations in the IA of the administrative burdens appear to be underestimated[6].

- **Stakeholder consultation**

The IA appears to have consulted a broad spectrum of stakeholders (Member States, public authorities, contracting entities, regional and local authorities, companies, trade unions, trade associations, NGOs and citizens; the Commission also received contributions from a few third country governments and trade organisations).

An open internet consultation was carried out between June and August 2011, but the Commission warns that it 'did not provide a necessarily fully representative picture of opinions and the results should therefore be read with some caution' (IA, p. 5). A summary of results of this public consultation is added in Annex II to the IA.

The criticism of the Commission's IA Board that the draft IA does not explain why the option which is least preferred by all stakeholders is selected as the preferred option, does not seem to be adequately addressed. The final IA only states that 'Approach B (the preferred option) also received the support of a considerable number of respondents' (IA, p. 6).

- **Monitoring and evaluation**

Article 19 of the proposed Regulation provides that, at least every three years after the entry into force of this Regulation, the Commission shall submit a report to the European Parliament and the Council on its application and on progress made in international negotiations regarding access for EU economic operators to public contract award

[5] See paper by Renda (at p. 6) who argues that the de facto openness of EU markets for third country goods and services is understated and the de facto openness of third countries for EU goods and services is overstated.

[6] Paper by Renda, p. 6 ; paper by Vincze, at p. 7-9 and 30-31.

procedures in third countries undertaken under this Regulation. The IA contains detailed suggestions for indicators that can be used to assess the progress and effectiveness of the proposed regulation in achieving the specific policy objectives (at p. 41 and 42).

- **Commission Impact Assessment Board**

The Commission's IA Board issued a first, very critical opinion on a draft IA on 25 November 2011 and a second opinion, on the revised draft IA, on 20 February 2012. In the latter, the Board states that 'the analysis and evidence base supporting the need for, and the proportionality of the proposed EU action, remain weak'. It recommends the originating DG Trade within the Commission to provide greater evidence of the magnitude of the problem, to further refine the presentation of the options, to further improve the analysis of impacts, in particular by justifying assumptions and by avoiding underestimation of administrative costs. Finally, the Board asks to better justify the proportionality of the preferred option.

The final version of the IA, dated 21 March 2012, has given only partial follow-up to this criticism. Modifications made following the Board's second opinion are listed in Annex 11 to the IA.

- **Coherence between the Commission's legislative proposal and IA**

The legislative proposal appears to follow the recommendations expressed in the IA, i.e. Option 3B2, together with the complementary Option 6.

Chapter II

Summaries of expert papers

This Chapter contains summaries of the replies given by four specialist experts to the specific questions posed by the INTA and IMCO Committees.

1. Openness of EU public procurement market

Has the openness of the EU's public procurement market, compared to other trading partners, been properly evaluated? Has the *factual* versus *legal* openness of the EU public procurement market been assessed? Is the information on openness of public procurement markets provided in the Commission's impact assessment consistent? What about, notably, "uncovered" goods and services? To underpin the situation - could data be provided on openness of public procurement in 5 European capitals and 5 global cities (case study)?

Analysis of Dr. Renda

The main pillar that sustains the rationale built by the European Commission in the IA document is the fact that EU public procurement markets are more open than those of the EU27's large trading partners. However, this statement is far from correct, due to both methodological flaws in the Commission's argument, and to the difference between de jure and de facto openness of public procurement.

From a methodological viewpoint, GPA (WTO plurilateral Agreement on Government Procurement) commitments are a very incomplete proxy for procurement openness, since non-GPA countries can nonetheless accept bids and award public contracts to foreign companies, and also since both GPA and non-GPA countries have committed a much larger amount of procurement under Regional Trade Agreements and Free Trade Agreements than they did within the GPA (which, anyway, has seen a significant expansion of coverage in March 2012). In addition, the use of GPA commitments as evidence of de jure openness has been criticized by GPA-participating governments due to the incompleteness of the data available.

When one looks at the de facto openness of individual countries, evidence from the World Input-Output Database suggests that the EU27 are not significantly more open than their largest trading partners in terms of actual contracts won. To the contrary, countries like Korea and China seem more open than large European economies in terms of penetration ratios. Of course, the de jure perspective is very important for international trade negotiations, since it reflects the position officially adopted by a given national or regional government and is as such an element of negotiation; however, it is the de facto penetration ratio that should be taken as a basis to assess the current leverage potential

and the likelihood of retaliation in case of adoption of new regulatory instruments by the European Commission. Put more simply: if Chinese businesses are currently not in the position to penetrate easily all the procurement markets that are de jure committed, they will not consider full openness as a starting point of the negotiation. In this respect, if the European Commission perceives a lack of leverage in international negotiations, the reason would probably have to be found in the behaviour of Member States governments rather than that of non-EU countries. The problem – as will be stated below – becomes then one of subsidiarity, rather than multilateral trade talks.

The IA document does not properly evaluate the factual and legal openness of the EU public procurement markets compared to those of large trading partners.

Analysis of Mr Vincze

The method used in the document for assessing the openness of public procurement – as all subsequent analysis of impacts – rests solely on 22 selected sectors. The selection was probably undertaken by expert judgement. There is no indication in the text that some data or other supporting evidence was used. However, the selection is seen as being reasonable. The 22 sectors are also categorised according to the level of skills required and 'revealed quality elasticity' (RQE). This latter classification is based on the relative apparent role of quality and price in the competitive position of goods and services exported.

For the selected 22 sectors, a degree of dependency from public procurement was assessed on a five-point scale. This again is to a large extent based on expert judgement: the researchers have interrogated national legislation or websites of national authorities or contracting authorities to identify whether the main purchasers are private or public entities and whether calls for tender are conducted. The assessment of the degree of *de jure* and *de facto* market openness for the 22 sectors was done - for the 12 key partners - through a rather elaborate review of the (GPA or other) commitments of the third countries concerned towards the EU, including specific derogations. This approach allows only for a very broad classification, blurring considerable differences. This assessment for the EU (e.g. in the form of an additional table showing the commitments of the EU towards its key trading partners) is however missing from the Impact Assessment, there is consequently no comparison of the degree of market openness in the EU and its trading partners.

As for non-GPA relations, it is not explained in the Impact Assessment what kind of restrictions apply in respect to countries with which the EU has concluded a free trade agreement (FTA) or a Stabilisation and Association Agreement (SAA).

For gauging the *de facto* openness of the EU's public procurement market, there is a wealth of possible hidden market entry barriers that are not regulated by international agreements but are often used by contracting authorities – e.g. requiring past working

experience in the country concerned, asking for country-specific certifications, publishing tender documents in the national language only, not accepting documents issued in a different language without official translation, short deadlines, etc. These are not quantifiable but can have a major impact on the opportunities of foreign bidders wishing to enter the market.

The figures on the volume of 'contestable' public procurement markets are equally rather broad estimates. As rightly pointed out in the IA, detailed data on public procurement activities of third countries is unfortunately very difficult to procure.

It should be pointed out that the relevant market size, i.e. above-threshold public procurement, is only a fraction of the total public procurement volume.

It was not possible within the boundaries of the assignment to undertake case studies on the openness of public procurement in 5 European capitals and 5 global cities. However, a review of contracts above the EU-thresholds awarded to third-country economic operators in 2011 reveals that these companies could access directly – i.e. not through EU subsidiaries or dealers – only a very small number of contracts (0.2% of all). Contracts won by third country economic operators include a high number of relatively low value purchases of medical equipment and pharmaceuticals from (predominantly Swiss) specialised suppliers, but also high-value procurement of, for instance, rolling stock, fuels, or academic journals (EBSCO from the US). In terms of value, the league table of third countries is led by Switzerland by a wide margin; the United States and Turkey follow.

2. Potential benefits of market opening

What about the potential benefits of new markets, has the value of these markets in euro been consistently and correctly assessed? Are there any more precise figures in terms of turn-over of contracts won by EU companies in third countries?

Analysis of Dr. Renda

The Commission implies, in the IA, that large trading partners have limited incentives to open up their procurement markets since the EU has already almost fully opened its own. Accordingly, there is no additional commitment that the EU can offer to trigger reciprocal concessions. It is argued above that this description of reality is flawed in a number of respects. The following conclusions can be drawn for what concerns the potential for market opening in third countries.

- First, the Commission declares that at least 50% of uncommitted Public Procurement in its 12 largest trading partners is not open, leading to 12 billion euro of untapped exports and 180,000 corresponding jobs. However, Annex 8 to the IA reveals that, in most cases, countries apply only partial limitations or constraints to public offering

(e.g. 15% local content requirements, 2.5% price differentials, etc.): these measures cannot be understood as fully blocking the markets in which they apply, although of course they can become hurdles to a full participation of EU businesses.

- Secondly, businesses that bid for the provision of a certain service rarely cover the whole supply chain of that given service. Especially in the era of global value chains, delocalization of production and reliance on local suppliers would not always entirely disrupt the business case of large EU bidders – at the same time, they could be damaging for some European SMEs or large companies that would have otherwise participated to the supply of the service or good at hand.
- Thirdly, it will anyway take years before emerging markets are fully opened de facto. Accordingly, the untapped exports and associated jobs must be discounted based on time and also on the likelihood that de facto openness will indeed occur. This makes the Commission's estimate questionable, and worthy of a re-assessment.

3. Impact on job creation of the different options

What about the consistency and assumption of methodology used for evaluating the impact on job creation and working conditions within the public procurement internal market and impact on EU environmental and social standards of the different options? Is it consistent that for very different scenarios the same figure of jobs created has been calculated? Has the impact on jobs from both exports and stemming from procurement of domestic goods and services been evaluated? What is the impact of the proposal (notably Articles 6, 10 and 7) with regard to working conditions and respect of environmental and social criteria set at EU and national level?

Analysis of Mr Vincze

The impact of the policy options on job creation is directly derived from the expected impact on export volumes; specifically i) from additional expected export due to market opening; and ii) from losses in existing exports expected due to retaliatory actions.

The Commission assumes a fixed ratio between export and corresponding job creation: 15 additional jobs for every €1 million of additional exports. This ratio is said to be calculated on the basis of the symmetric input-output tables for the EU-27 and individual Member States. However, the method - as it was not explained in the document in more detail - is not clear, and it could not be replicated by looking at the relevant data sources.

Although sufficient information to review and analyse the exact method used is not available in the document, it can be presumed that it carries the possibility for certain biases:

1. The method probably leads to an overestimation of the potential of additional EU exports to create/safeguard European jobs. The IA mentions that the method does not take into account efficiency gains and spare capacity; but there are at

least three other reasons why the fixed ratio applied may be a significant overestimation:

- most of the 22 sectors identified in the IA as being dependent upon public procurement are highly capital-intensive, i.e. their direct employment generation potential is lower than that of other sectors which were included in the calculations;
- European access to third-country public procurement markets will probably be dominated by relatively large contracts, thus by large enterprises which generally have less labour-intensive production processes than smaller enterprises which are also included in export statistics;
- projects undertaken in third-country public procurement markets would by all probability have a higher local or at least non-EU content - including local staff - than general exports, considering that authorities are likely to formulate such requirements or that bidders are likely to improve their chances of winning the contract – as well as ensuring effective delivery – by teaming up with local providers.

2. Evidently, the method cannot take account of the fact that the positive impacts of the policy options in terms of additional exports will occur in different sectors and different Member States – all with very different employment-generation potential. The document did not analyse in more detail which export markets are likely to be opened up (to a larger extent) to European economic operators, mainly due to uncertainties about what the EU, even with its increased leverage, could achieve in trade negotiations.

3. All export and associated employment impacts were calculated only in relation to the 12 key trading partners of the EU. Evidently, the policy options will also impact on other bilateral trade relationships.

4. Most importantly, the employment impacts stemming from a reduction in imports and the wider supply chain impacts seem to be missing from the assessment.

5. Some of the minor working assumptions used for the calculations may also be challenged; for instance, under Option 2A, the assumed 50% usage of Article 58 of the Utilities Directive to reject offers from third countries seems to be too high.

The IA assumes an additional export volume of €2 billion for policy option 2A, and with €4 billion for policy options 3A, 3B, 3C and 4, assuming that the EU will be able to obtain open access to all markets in the 12 key trading partners where these trading partners have offensive trade interests. Whilst it would seem odd that the same figure has been used for four different policy options, this is not an unreasonable assumption. It is not possible to foretell the outcomes of the negotiations, and the 'realistic' estimate of €4 billion in additional exports can be contested, but relatively small differences in the policy options will probably not have a significant impact on the EU's

leverage/negotiation power or on the trading partners' offensive interests, hence on the expected additional export volumes.

It should be also noted that the assessment does make a distinction between the policy options in terms of level of rejected imports and related supply chain effects, as well as the expected level of retaliation from third countries. These effects modify the ultimate expected impacts significantly.

One crucial gap in the calculations is the omission of the impact on job generation from replacing imports with domestic production in cases where offers from third-country economic operators will be rejected. The policy options for which the impacts were quantified (i.e., 2A, 3A, 3B, 3C and 4) assume that, if implemented, a certain amount of third-country imports will be rejected by contracting authorities and entities. Estimates were made in the IA on what the volume of this would be, and also on the volume of European export built into this import volume (supply chain impact) that would not materialise in case of a rejection. One part of the rejected imports will be replaced by imports from other countries, e.g. GPA-signatories against whom no restrictions are applied. However, the remaining part of rejected imports will be produced within the EU, thus clearly having an employment impact, which has not been estimated in the IA.

The IA says very little in relation to the expected impacts of the options on working conditions, environmental and social standards on the internal market. It is known that very substantial differences exist between social and environmental regulations in force in the EU and most third countries. Whilst European regulations are relatively strict (even if economic operators do not always abide by the rules in practice, as witnessed by national labour inspectorates), rules and their enforcement are currently much laxer in the majority of emerging markets and developing countries.

The document briefly discusses, in a qualitative manner, that barriers to third country goods and services may undermine the incentive of foreign firms to adopt stricter environmental and social standards – although the impact is considered to be merely marginal.

As concerning impacts occurring in the EU, reduced imports (more domestic EU production) are very likely to lead to shorter transport distances, hence a slightly lower burden on the environment. Conversely, it may be added that an increase in EU exports to third countries (as it generates economic activity in the EU as well as long-haul transports) may lead to an additional environmental burden. Increased export volumes of successful export-oriented industries through better market access, and rejecting foreign companies who may aggressively undercut domestic rivals by not offering the same working conditions can only improve the overall situation in terms of working conditions in the EU.

Knock-on effects on environmental and social standards are therefore likely to be so marginally small that an IA will indeed not be able to quantify them.

4. Risk of retaliation and leverage creation

Is there evidence of the Commission's assumption that the more an option limits access to foreign goods and services the higher the risk of retaliation is? Is the Commission's estimate of the risk of retaliation consistent and based on evidence and a proper methodology? Has the potential of leverage for market opening in third countries being properly assessed? Taking into account game-theory - what assumptions can be made about the risk of retaliation for each of the proposed options and possibilities to create leverage for negotiations through this instrument?

Analysis of Dr. Renda

The flawed problem definition leads the Commission services to wrongly assess the risk of retaliation and the potential for leverage creation. The former is much more likely than the Commission seems to assume; and the latter is lower than the Commission thinks, since the EU is not the only – and soon, not anymore the most important – trading partner of these countries.

Analysis of Dr. Telles

All the solutions proposed by the European Commission could potentially lead to retaliation from third countries and it is impossible to map out their entire scope. Furthermore, irrespective of the solution adopted, it is not certain that retaliation would only happen in the same public procurement markets. It is entirely possible that an aggrieved third country could simply decide to retaliate on other trade areas with direct impact on the European SMEs in that market. This may be the biggest risk for EU companies as it could impact export led companies and even the operations of companies inside Europe.

Analysis of Prof. Dimitri

Strategic considerations, based on a stylised game theory approach, can illustrate a fundamental difficulty for opening public procurement markets by the EU and third countries. Such difficulty, formalised by the fact that closing public procurement markets can be a strictly dominating strategy of the game, for both EU and third countries, arises when decisions to open the market are based on the monetary value of the available public procurement contracts. In negotiations this would be a position reflecting more the interest of business firms than the interest of contracting authorities.

An analogous position, more favorable to business companies than to contracting authorities, would be taken by the EU and third countries if their decisions in negotiations are based on the estimated monetary sums that business firms effectively receive, from the contracting authorities, for the awarded contracts. Also in this case, the

same strategic difficulty would emerge as closing their domestic procurement markets could still be a strictly dominating strategy of the game, for both EU and third countries.

Taking the point of view of the contracting authorities, aiming to deliver best value for money, as when savings are maximized for given quality level, the strategic scenario might change. The party, either the EU or third countries, with the most competitive firms may tend to take advantage of this position to keep its domestic market closed, or more protected, while the other party open. Indeed, the contracting authorities of the party with less efficient firms may find it profitable to allow external firms to enter their own public procurement markets to enhance higher savings.

Under certain conditions, also within a business firms' perspective a dynamic framework, that is a game theory approach where the EU's and third countries' future gains and losses are explicitly considered in the model, can favor reciprocated open public procurement markets.

If open trade is considered to be desirable by the EU, based on the above considerations, our findings seem to suggest that EU policy measures, and negotiation efforts, should try to increase the value of open domestic public procurement markets, rather than further restricting entry of/supplies from third countries' companies in the EU market.

5. Administrative burden of assessed options

Is the estimation of the number of notification cases correct? What about the methodology to estimate the additional administrative burden? How detailed and reliable is the assessment? What about the additional costs for each contracting authority in relation to the volume of the public procurement? How sound is the estimate of the number of cases for notification?

Analysis of Mr. Vincze

The method is not well described and hence difficult to follow. The IA works on the basis of a much higher number of notifications than the explanatory part of the Commission's proposal (34-45 notices per year expected). The administrative burden on companies only calculates with €5 per certification of origin, probably not taking appropriate account of the time and effort preparing these. No one-off administrative costs (setting up new procedures etc.) have been included in the calculations and the obligation to contracting authorities to indicate a possible waiver in the standard forms should also be considered an administrative burden.

Analysis of Dr. Renda

Administrative burdens are tentatively assessed, but this is unlikely to be a major problem for this IA document

6. Impact on SME

To what extent the impact for SMEs has been evaluated? Are there some options more beneficial for SMEs than others?

Analysis of Dr. Renda

The IA only deals with the impact on SMEs in a very limited way, only for their potential for internationalisation. However, the impacts might be more important for those SMEs that are involved as local suppliers in bids placed by third country companies in EU procurement markets. The impact assessment should also have taken into account administrative burdens and compliance costs (such as certificates of origin) that could disproportionately fall on SMEs.

Analysis of Mr Vincze

There is little discussion in the impact assessment of the impact of policy options on SMEs. The internationalisation of SMEs is mentioned as a cross-cutting impact. One of the comments of the Commission's IA Board was that the magnitude of the problem for SMEs has not been dimensioned.

SMEs are not mentioned in the IA as possible beneficiaries of import replacement in case bids from third countries are rejected in European public procurement.

Analysis of Dr. Telles

European SMEs tend to bid for contracts much lower than the threshold of 5 million euro proposed by the Regulation and they do not take part directly in most contracts covered by it. Any SMEs participating in supply chain or sub-contracting roles in tenders subject to the notification procedure would still be affected.

Cross-border SME procurement participation is limited and the proposed Regulation does not address any of the already identified cross-border barriers. Therefore, it is unlikely that the proposed rules will have a direct positive impact for SMEs, other than supply chain opportunities on larger contracts tendered in third countries. Even those benefits are uncertain.

The 'inward impact' of the Regulation (on the internal market) has not been thoroughly explored in the Impact Assessment although some impacts can be anticipated.
The most important risk for EU businesses, including SMEs, seems to be the risk of retaliation outside public procurement by third countries. This risk has not been taken into consideration.

All solutions proposed by the European Commission could lead to retaliation and other impacts on SMEs, but it is impossible to measure them with precision.

From a perspective of the transaction costs for SMEs, option 3A (legislative approach without supervision by the Commission) or a system like the one currently in place in Austria, Italy or Spain that targets the origin of the supplier itself, would potentially affect less European SMEs.

7. Justification of thresholds

Has the 5 million euro threshold been assessed? Have the reasons in terms of cost and benefits been assessed for setting up this threshold? Is the estimation of the number of notification cases correct?

Analysis of Mr. Vincze

The threshold of 5 million euro, as suggested in Article 6 of the legislative proposal - exceeding GPA thresholds for supplies and services by a wide margin – or optional thresholds have not been assessed in the document. Bringing the thresholds to a lower level may result in a larger share of rejected imports but could possibly give rise to more retaliation.

Analysis of Dr. Telles

European SMEs tend to bid for contracts much lower than the proposed threshold of 5 million euro by the Regulation and they do not take part directly in most contracts covered by it. Any SMEs participating in the supply chain or acting as sub-contractors in tenders subject to the notification procedure would still be affected.

The 5 million euro threshold is similar to some of the current thresholds for the application of EU public procurement rules. It will cover a limited number of contracts which may reduce its effect as a credible threat to force third countries to open their procurement markets.

The proposed threshold seems to be a compromise between having a threat in place and the transaction costs imposed on contracting authorities and the European Commission by being applicable to a small number of strategic contracts.

A lower threshold would increase the transaction costs for all involved (contracting authorities, direct and indirect suppliers and the European Commission) but at the same time make a more credible threat to third countries. As a consequence, however, retaliation would be more likely.

The estimated number of 554 notification cases per year seems ambitious. The lack of incentives for contracting authorities to refer a procedure to the European Commission does not appear to have been taken into account.

8. Existing national legislation restricting access to public procurement markets

Is there any more detailed information available on the existing national and regional legislation restricting access to public procurement markets? Which mechanisms have been put in place and can any lessons be drawn from this legislation?

Analysis of Dr. Telles

The local mechanisms developed by EU Member States lead to three different kinds of reciprocity clauses: (i) excluding suppliers due to their origin (Austria, Italy and Spain); (ii) excluding tenders due to the origin of goods (Belgium); and (iii) exclusion of access to remedies (United Kingdom).

There is no evidence of widespread use of reciprocity clauses in Member States such as Austria, Italy or Spain. In the first two cases, the use seems limited and in the third non-existent.

The lack of evidence of the use of reciprocity clauses appears to be the key lesson to be drawn from this legislation: without incentives contracting authorities will not be excluding foreign bidders.

There is no evidence that the United Kingdom has a reciprocity clause other than an apparent restriction imposed in the access to remedies by suppliers based in third countries. Furthermore, the UK Government has spoken against the proposed Regulation in no uncertain terms.

National reciprocity clauses (that exist in Austria, Italy and Spain) appear to target the origin of the supplier and not the origin of the goods being supplied as it is the case with the proposed Regulation. This approach avoids the risk of being used for protectionist purposes against bidders based in other Member States but can easily be avoided by the creation of subsidiaries or similar strategies.

Detailed appraisal
of the European Commission's Impact Assessment

Rules concerning third countries' reciprocal access to EU public procurement

Commission proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries (COM(2012) 124 final)

ANNEX I

Methodological aspects

Research paper
by Andrea Renda

Abstract
This briefing note addresses eight specific issues identified by the European Parliament Committee on International Trade (INTA) and related to the Commission's proposed new rules concerning third countries' reciprocal access to EU public procurement. The main findings are that, while the European Commission points the attention to a serious policy issue and the Impact Assessment (IA) document is in many parts detailed and informative, the Commission should have assessed more accurately the current level of *de facto* openness of EU and non-EU public procurement markets, which is not as imbalanced as the document states. At the same time, the Commission IA does not fully take into account the costs that the preferred policy option would entail both in terms of retaliation by trading partners, and in terms of additional costs for taxpayers due to less competition in internal EU domestic markets. The briefing note also states that some aspects of the proposal (e.g. subsidiarity, the €5 million threshold and the impact on SMEs) are not fully assessed or entirely missing in the IA document. As a result, the European Parliament should focus on ensuring that the proposed "reciprocity-enhancing" instrument does not undermine at once the future prospects of EU businesses in large international procurement markets, the prospects of EU SMEs in participating to intra-EU bids led by non-EU businesses, and the potential benefits that would derive to European citizens from a reduction of government spending triggered by more competitive procurement.

AUTHOR
This study has been written by **Prof. Dr. Andrea Renda** of the Centre for European Policy Studies, at the request of the Impact Assessment Unit of the Directorate for Impact Assessment and European Added Value, within the Directorate General for Internal Policies (DG IPOL) of the General Secretariat of the European Parliament, following a request of the Committee on International trade (INTA)

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Executive summary

Global trade is currently exhibiting a reduction in the relative weight of developed economies (and in particular the EU27) and a parallel increase in the share of emerging economies. Even if for different reasons, both developed countries and emerging countries have developed an interest in a more protectionist approach to trade. The former, facing an unprecedented economic downturn, fear excessive penetration by cheaper, often state-subsidized competitors from emerging countries; the latter are eager to build domestic capacity (as is the case for China's indigenous innovation policy). Since all countries have already taken multilateral commitments to eliminate barriers to trade within the WTO, the domain in which protectionist measures become easier to implement is public procurement, which accounts for 15-20% of GDP in most countries: many emerging countries do not yet adhere to the plurilateral Government Procurement Agreement (GPA), where the EU has officially committed an unmatched percentage of its procurement, estimated at 85%. The US, for example, has not gone beyond 32%.

Against this background, the European Commission proposal envisages the creation of a new instrument, which would allow national contracting entities to exclude goods or service providers originating from non-EU, subject to an *ex ante* notification to the Commission; and would also allow the Commission to launch investigations on protectionist measures in non-EU countries and ultimately adopt restrictive measures against bids originating in these countries, should they refuse to engage in negotiations.

The Commission proposal rests on two main statements: (i) other countries have not committed the same amount of procurement markets in the GPA, and as such are way less open than the EU, which hampers EU interests in these markets; and (ii) the Commission does not have enough leverage in international negotiations, since – given that it already opened all its markets – there is not much more than the Commission can offer as a "bargaining chip" to other countries to trigger reciprocal concessions. **This briefing note claims that both statements – which are the basis for the whole initiative – are highly questionable**.

More in detail:

- **Concerns about lack of participation and official commitment to openness in the GPA have some merit** in light of the recently reported increase in protectionist measures in both developed and emerging economies. **However, the Commission might be overstating this problem for several reasons**: (i) the EU is not as open *de facto* as it claims to be *de jure*; (ii) countries such as China, Japan and Korea feature a level of *de facto* openness that is very similar to that of the EU27; (iii) the GPA revision in March 2012 has seen a significant expansion of commitments; and (iv) regional and bilateral trade agreements, including the ones that the EU is negotiating or about to start negotiating (e.g. the TTIP) can significantly increase procurement openness in the coming years – this also implies that even if one considers only *de jure* openness as the relevant measure, GPA commitments would be a very imperfect proxy.

- **This problem definition leads the European Commission to mis-measure the potential for market opening in third countries**: in particular, the statement that at least 50% of uncommitted Public Procurement in large trading partners is not open is exaggerated. **As a result, also the estimated impact of the preferred option on job creation appears over-stated.** In the era of "global value chains", banning foreign bids might mean damaging EU SMEs: the recent protests by German SMEs against the EU-proposed tariffs on Chinese solar panels, which are expected to lead to a loss of up to 200,000 German jobs, are a clear demonstration of this fact.

- **Due to the representation of the problem, the Commission Impact Assessment ends up mis-evaluating the risk of retaliation and the potential for leverage creation.** The former is much more likely than the Commission seems to assume; and the latter is lower than the Commission thinks since the EU is not the only – and soon, not anymore the most important – trading partner of these countries.

This briefing note also finds that **some aspects of the Impact Assessment would have deserved a more in-depth analysis**: administrative burdens are only tentatively assessed; the 5 million Euro threshold for public contracts covered by the newly proposed instrument is not discussed at all in the IA document; and the IA document downplays the *de jure* and – even more importantly – *de facto* protectionist measures being taken by some EU Member States.

Finally, the Impact Assessment seems to partly or fully neglect three very important issues:

- **Shifting global trade shares** are changing the landscape of international trade;
- **Subsidiarity** should have been addressed more in-depth in the Impact Assessment, as the preferred option shifts competences and powers from the Member States to the EU level; and
- Notably, **the impact of potential higher procurement costs and reductions of competition in procurement on taxpayers** is not fully addressed in the IA document.

The briefing note concludes by recommending that these aspects are taken into account by the European Parliament when dealing with the Commission proposal, and suggests a more accurate reflection on the merit of creating an instrument which would, at once, generate a significant risk of retaliation by large trading blocs, and perpetuate the lack of leverage in international negotiations. The briefing note also suggests that the current lack of leverage might be approached more as a problem of internal coordination of the EU (and thus, an internal market problem), rather than a problem to be solved outside the EU.

1. Introduction: public procurement and international trade

This document contains an analysis of the European Commission's Impact Assessment on rules concerning third countries' reciprocal access to EU public procurement, as requested by the Impact Assessment Unit of the Directorate for Impact Assessment and European Added Value, within the Directorate General for Internal Policies (DG IPOL) of the General Secretariat of the European Parliament. The document is structured as follows. Section 1 below sets the stage by providing an analysis of how the EU has responded to the competitive challenge posed by globalization and by the rise of emerging economies such as China, Russia, India and Brazil, and how the relative strength of developed and emerging economies is likely to affect global trade in the coming year. In addition, the same section contains a number of observations as regards the current level of openness of trade and in particular public procurement, with reference to the existing Government Procurement Agreement (GPA), but also existing Regional Trade Agreements (RTAs), Free Trade Agreements negotiated by the EU (FTAs) and other bilateral agreement, which – as will be observed – lead to a much broader opening of public procurement than the GPA alone. Section 3 looks at specific aspects of the European Commission's Impact Assessment document, from the assessment of the degree of openness of procurement internationally, to the differences existing between *de jure* and *de facto* commitment, the impact on jobs, small and medium-sized enterprises (SMEs) and administrative burdens, and the relevance of the 5 Million Euro thresholds that the proposal identifies as the relevant one for triggering the proposed new EU instrument related to third countries' reciprocal access to public procurement. Other items that, in the author's opinion, should be revised and improved in the current Impact Assessment include the treatment of subsidiarity and the overall impact of the various alternative options on taxpayers. Finally, Section 4 concludes by offering some final remarks.

2. The global trade context and EU's policy response

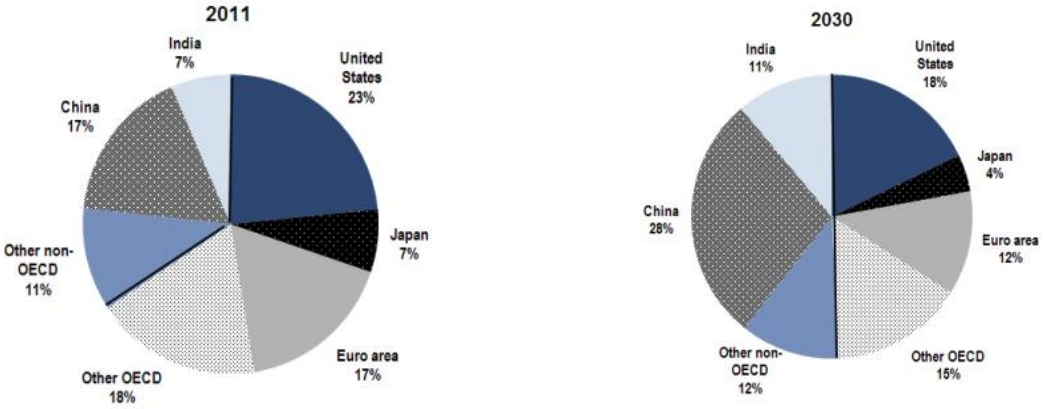
Globalization has brought significant gains to the whole world, and also to Europe. Major effects of decades of increased globalization include the acceleration of technological innovation; the opening up of new markets and export opportunities for least developed countries; the consequent reduction of poverty in many areas of the world; net inflows of labour, greater production and GDP growth, low inflation and, overall, a clear path towards prosperity. To say it with Hamilton and Quinlan (2012), "on balance, Europeans are living better today than they were when the Iron Curtain fell and the Cold War ended, in part because of globalization".[7]

[7] Hamilton, Daniel S. and Joseph P. Quinlan (2008), Globalization and Europe: Prospering in the New Whirled Order, Washington, Center for Transatlantic Relations, The Johns Hopkins University.

However, a number of important trends are now challenging Europe's positioning in the global landscape. These include the following:

- *A major reshuffling of global GDP shares:* the share of the BRICS in world GDP increased from 17% in 1990 to 28% in 2010, mostly due to the rise of China (13.5%) and India (5.5%). In 2011, according to the Organization for Economic Cooperation and Development (OECD), the share of world's GDP held by China had already jumped to 17%, reaching the euro area and not far from the US (23%). A recent report by the OECD (2012) also forecasted that "China and India will experience more than a seven-fold increase of their income per capita by 2060, bringing China 25% above the current (2011) income level of the United States, while income per capita in India will reach only around half the current US level".[8]

Figure 1 – share of world GDP in 2011 and forecast for 2030, OECD



Source: OECD (2012)

- *Europe has lost competitiveness over the past decade.* The EU's economic performance had been disappointing much before the advent of the economic downturn. Already in 2004, when the "Kok Report" was published, Europe's struggle to regain competitiveness already appeared as an uphill battle, and the ambitious goals set in 2000 with the Lisbon strategy looked more like mirages than concretely attainable targets.[9] The Kok report stated that "Europe faces two enormous challenges – increasing global competition and a rapidly ageing population… to safeguard and strengthen [Europe's] distinctive economic and social model, it must adapt." Today, Europe is again in a similar situation, with most of the targets set by European Commission's 'Europe2020' growth agenda being impossible to achieve, and the economy approaching recession in at least some of the largest European member states (France, Italy, Spain). As a matter of fact, in the past decade productivity growth has been consistently low and falling. Given the negative demographics of the EU, without a boost in productivity – currently, quite unlikely – no growth will be attainable in the future.

[8] "Developing countries to eclipse the West", *Guardian*, 9 November 2012.

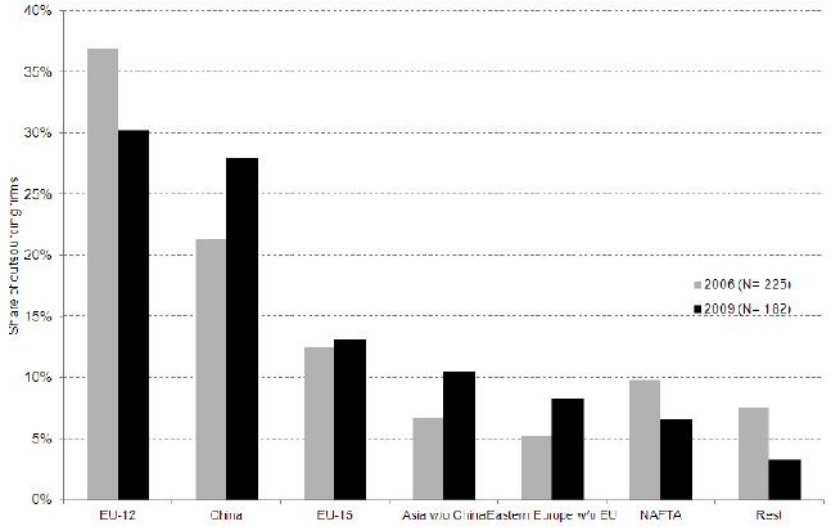
[9] Kok, Wim, ed. (2004) Facing the Challenge: The Lisbon strategy for growth and employment (Kok report), Luxembourg, Office for Official Publications of the European Communities, November, available at this link.

- *A changing role in global value chains?* Even before the crisis, the EU industry had already begun to face severe difficulties in global competition, due to the emergence of so-called "global value chains" and the pressing need to outsource and offshore industrial activities in countries with lower labour costs. The internationalization of industrial production has led to a declining contribution of EU economy on total world output. Cases of R&D externalization, open innovation, global production sharing, (international) fragmentation, "slicing up the value chain", vertical specialization, international (out)sourcing, off-shoring, have become very frequent in many industrial sectors, and have consistently led to an outflow of production from Western Europe towards Central and Eastern European countries ("*near-shoring*"), and later towards non-EU countries ("*far-shoring"*).[10] The recent European Competitiveness Report released by the European Commission, DG Enterprise and Industry, identifies a worrying trend of industrial relocation outside the EU15, mostly towards the EU12 and to China (see also figure 2 below). And while US authorities have started to pay attention to keeping know-how at home, by encouraging their private businesses to repatriate part of the value chain (see *e.g.* the iPhone's production process between Apple in the US and Foxconn in China), European corporations seem to be losing their control over key industrial know-how, to the advantage of other regions in the world.[11]

[10] 'Offshoring' and 'offshore outsourcing' refer to a company's decision to transfer certain activities that have so far been carried out inside the company to either another unit of the firm in a foreign location (intra-firm or captive offshoring) or to an independent firm (offshore outsourcing).

[11] A famous and often quoted example is the Boeing 787 Dreamliner. It is presently produced by 43 firms in 135 locations all over the world. From Boeing's headquarters in Chicago 70 percent of all tasks are offshored: a way of producing an airplane that was unfeasible before the 1990s. The value added embedded in the Dreamliner as a final product is thus generated by all these firms and in all these locations. This is partly due to the rapid progress in information and communication technologies (ICT). Liberalization of international trade and investment has also been helpful.

Figure 2 – Main destinations of production relocation



Source: European Commission Manufacturing Survey, 2006, 2009

- *As a result, at least in some sectors of the economy, the EU has become more an "assembling" regional bloc, rather than a producing one*. This is particularly true in the automotive sector, which marks a major difference compared to what the Barack Obama administration has done in the United States to maintain the bulk of value-added activities in US territory. Both Cernat and Pajot (2012) and Lee-Makiyama (2012) observe that the value added of employment in the car sector in Europe has fallen significantly, and is now behind that of Brazil in many large EU member states. The "assembled in Europe" phenomenon is of course not a problem *per se*, but becomes a problem if the value added component of the production chain gradually moves outside Europe. This is why the EU trade strategy, especially as regards free trade agreements with important commercial partners, should take into account the need to avoid outflows of know-how and value added activities.

The EU trade strategy: a look at the past decade

In the past few years, Europe has been reflecting on how to change its trade policy strategy to respond to these challenges. In 2002 the Commission's Communication on Trade and Development made commitments to granting developing countries greater access to the EU market, providing adequate funding for trade-related assistance, and making trade a central part of development strategies. The commitments included using trade agreements to promote greater market access, support regional integration and improve trade rules to promote development. The EU market has traditionally been the most open to developing countries. Fuels excluded, Europe imports more from least developed countries (LDCs) than the US, Canada, Japan and China combined.

In 2006, in the wake of the re-launch of the Lisbon growth strategy, the European Commission took stock of the need to thoroughly rethink competitiveness-related policies both "at home" and "abroad", in the belief that competitiveness is a game that must be played on both grounds. The Communication "Global Europe: Competing in the world" (COM(2006) 567) set the stage for an ambitious "shift of gear" in EU policy. The underlying belief, for what concerns trade policy, was that "openness to global trade and

investment increases [Europe's] ability to exploit the benefits of an effective single market", since it "exposes the domestic economy to creative competitive pressures, spurring and rewarding innovation, providing access to new technologies and increasing incentives for investment". As a result, Europe made the important choice of refusing protectionism in the name of global competition, although it was rather ambiguously added that "imposing temporary and targeted restrictions on anti-competitive imports into Europe can play a role in defending European interests against unfair trade"[12].

Overall, the logic of Europe's 2006 trade strategy relied on the following pillars:

- *Trade openness boosts competition and productivity at home*. This means that the EU rejected protectionism as a way to preserve employment and prosperity at home. More generally, for a long time the concept of "industrial policy" has been far from popular at the EU level, where competition policy was heavily used to open up markets intra-EU and avoid the protection of national champions. Some member states, however, have traditionally sought a more mixed strategy, especially in some heavy industry sectors and network industries.

- *The Single Market is needed to create the economies of scale and the competitive pressure needed to conquer foreign markets and attract imports and FDI at home.* This means that completion of the single market – especially in the services sector – can boost Europe's potential for conquering new markets abroad, by stimulating competition and consolidation of service providers within the EU27.

- *Trade policy should focus on bringing European values abroad and create the preconditions for opening and liberalizing foreign markets.* In the opinion of the European Commission, emerging markets are still too often relying on protectionist measures in their national growth strategies. These can take the form of tariff and also, increasingly, non-tariff barriers. On the other hand, European institutions believe that openness on both sides means mutual growth possibilities, and should be made a precondition when negotiating free trade agreements and other trade partnerships.

That said, and also given the ongoing stalemate of Doha round negotiations, on which the EU had initially devoted significant effort, the EU trade strategy has moved towards a constellation of instruments aimed at awarding different conditions to different trade blocs. This complex galaxy includes: (i) *The Generalized Scheme of Preferences (GSP)* adopted under the recommendation of the UN Conference on Trade and Development (UNCTAD) and aimed at facilitating trade between the EU and developing countries; (ii) the *Aid for Trade* (AfT) initiative, launched in 2007 in cooperation with member states, which led to the allocation of a large portion of EU development funds to trade-related projects; (iii) *Economic partnership agreements (EPAs)*, which the EU started to negotiate with African, Caribbean and Pacific (ACP) countries in 2002 (after the Cotonou agreement), leading to a comprehensive, regional EPA signed with the CARIFORUM group of states in the Caribbean; (iv) *Free trade agreements*, initially concluded with countries like Chile and Mexico, and then re-launched in 2006, targeting India, Ukraine,

[12] See SEC(2006)567, Section 3.1, page 4.

South Korea and Japan[13]; and (vi) *"region-to-region" free trade agreements*, as part of its endeavour to foster regional integration and reduce transaction costs in international negotiations[14].
The EU has further engaged in *strategic cooperation* with a number of governments, from China to Brazil, Canada and the United States, India, Japan and Russia. These looser forms of cooperation have been in some cases complementary, in other cases alternative to FTA negotiations.

In the case of both Canada and the US, cooperation has also taken the form of a stable *regulatory cooperation* platform, aimed at reducing divergences between rules and standards adopted on the two (northern) sides of the Atlantic.

The 2010-2012 trade policy strategy: a mixed picture, or a U-turn?

Between 2010 and 2012 the European Commission has adopted two communications that have shaped a refined approach to trade policy in the years to come.[15] The major new features of EU trade policy as it stands today can be summarized as follows:

- *A more targeted approach to the use of the GSP and AfT instruments*, aimed at reaching least developed countries, more than emerging economies. Evidence that only a minor portion of the AfT funding had reached LDCs will lead to a thorough restructuring of this budget item, together with a renewed emphasis on helping SMEs in developing countries exercise their rights.

- *A stronger emphasis on reciprocity*, in a time of resurgence of third party trade restrictive measures that hamper EU industries' access to foreign markets. For example, the 9th report on potentially trade-restrictive measures issued by the

[13] The key economic criteria for concluding new FTAs are the market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-tariff barriers); but increasingly, the EU states that potential partners' negotiations with EU competitors are also important. FTAs can carry risks for the multilateral trading system since they can complicate trade, erode the principle of non-discrimination and exclude the weakest economies. To have a positive impact FTAs must be comprehensive in scope, provide for liberalisation of substantially all trade and go beyond WTO disciplines.

[14] However, in most cases this has become a never-ending saga: with the Association of South-East Asian Nations (ASEAN), the Gulf Cooperation Council (GCC) and the Mercado Comùn del Sur (MERCOSUR) negotiations have stalled, often due to a failure to agree on very specific products or sectors. This has led the EU to seek a more bilateral strategy with individual countries, leading to comprehensive FTAs with Peru, Colombia and ongoing talks with Singapore, Malaysia and Vietnam.

[15] See European Commission (2010), Trade, Growth and World Affairs. Trade Policy as a Core Component of the EU's 2020 Strategy (COM(2010) 612 final), Brussels, 9 November; and European Commission (2012), Trade, growth and development. Tailoring trade and investment policy for those countries most in need (COM(2012) 22 final), Brussels, 27 January.

European Commission in 2012 observes a reinvigorated trend of "third countries' use of trade restrictive measures as part of new industrialization policies, aimed at shielding their domestic markets from international competition, continues to be confirmed in this report". The Commission quotes Brazil, China, India, South Africa and Ukraine among those countries that are trying to protect their national economies through restrictive measures; but also the recent expropriation by the Argentinean government of 51% of YPF shares owned by the Spanish company Repsol. In addition, the Commission observes that some of Russia's recent actions may not be in conformity with the obligations it has as new member of the WTO. Overall, between September 2011 and 1 May 2012, as many as 123 new potentially trade-restrictive measures were adopted around the world, whereas only 13 were withdrawn[16].

- *A stronger emphasis on promoting EU values and achieving broader public policy through trade policy*. In particular, the values that will be increasingly incorporated in preferential trade schemes are sustainability and respect for human rights. More specifically, the EU seems to target mostly Mediterranean countries and Eastern neighbourhood countries, announcing negotiations for Deep and Comprehensive FTAs with Egypt, Tunisia, Jordan and Morocco; and also with Armenia, Georgia and Moldova.

- *A more ambitious strategy to promote FDI in developing countries,* through provisions in Bilateral Investment Treaties that strengthen rule of law, legal certainty and investor protection.

- *An increased reliance on private standards and guidelines*. These mostly entail the inclusion, in trade negotiations, of public and private corporate social responsibility guidelines such as the OECD ones; standards on transparency along the value chain, such as the Extractive Industries Transparency Initiative (EITI), the Forest Law Enforcement, Governance and Trade (FLEGT) and the Timber Regulation; the recently updated OECD Guidelines for multinational enterprises; OECD's recommendations on due diligence and responsible supply chain management ; etc.

Overall the new EU trade policy has been criticized by experts and commentators, since it contains traces of revived protectionism and even "neo-colonialism", a more cautious approach to multilateral trade talks; an undesirable proliferation of instruments and goals; and dilution of trade objectives through commingling with other policy goals; and overall, the impression of a lack of clear ideas and strategies for the future.[17] Most importantly, the European Commission does not mention the enormous opportunities that it has missed in the past few years due to an internal collective action problem, which has hampered negotiations on key FTAs such as the one with ASEAN, MERCOSUR and the Gulf. No real strategy is offered to remedy these problems.

[16] European Commission DG Trade (2012), Ninth Report on Potentially Trade Restrictive Measures Identified in the Context of the Financial and Economic Crisis, September 2011-1 May 2012, June http://trade.ec.europa.eu/doclib/html/149526.htm

[17] See the collection of essays by the Overseas Development Institute (2012), "The next decade of EU trade policy. Confronting global challenges?", ODI Research Reports and Studies, July http://www.odi.org.uk/publications/6693-eu-trade-policy-international-development-global-challenges.

Public Procurement and trade negotiations: a rising concern

Within international trade talks, public procurement has become increasingly important over the past few years for a number of important reasons. First, the economic downturn in large developed countries has led to an increase in the share of public procurement over GDP, also due to the relative rigidity of government demand and investment compared to private sector expenditure. At the EU level, the share of public procurement over GDP increased from 17% in 2008 to 19.9% in 2010[18]. Second, countries that have joined the WTO have reverted to a number of less thoroughly regulated measures – compared to the traditional trade defence instruments and tariffs – to protect their economies. The share of non-traditional measures on the total protectionist measure is still predominant (Evenett, 2012). Third, the combination of globalization, the digital economy and economic crisis has led to growing focus, in developed economies, on the need for infrastructure investment, which requires increasingly large public procurement. Finally, with globalization most of the heavy industries in developed countries have started to suffer from competition by often state-subsidised large enterprises from emerging economies: this was the case in sectors such as steel and aluminium, and (relatedly) railways and automotive.

Figure 3 – Ten most used measures to discriminate against foreign commercial interests since the first G20 crisis meeting

State measure	Number of discriminatory (red) measures imposed since November 2008		Number of discriminatory (red) measures imposed and still in force		Number of jurisdictions that imposed these discriminatory measures since November 2008		Number of jurisdictions harmed by these discriminatory measures since November 2008	
	At June 2012	Increase from previous G20 meeting (November 2011)	At June 2012	Increase from previous G20 meeting (November 2011)	At June 2012	Increase from previous G20 meeting (November 2011)	At June 2012	Increase from previous G20 meeting (November 2011)
Bailout/state aid measure	361	88	247	New entry in the 2012 report - comparable data not available	48	-1	189	3
Trade defence measure (AD, CVD, Safeguard)	316	92	285		62	4	86	5
Tariff measure	178	46	135		70	7	153	-4
Non tariff barrier (not otherwise specified)	117	29	107		28	4	148	-5
Export taxes or restriction	90	20	59		57	3	178	-8
Investment measure	49	7	49		29	1	81	0
Migration measure	49	5	44		25	1	106	2
Export subsidy	41	4	40		42	0	198	-1
Public procurement	41	2	36		21	0	135	0
Import ban	32	n.a.	29		24	n.a.	98	n.a.

Source: Evenett (2012)

Procurement is regulated *i.a.* by the WTO Agreement on Government Procurement (GPA), which is a "plurilateral" agreement and – as such – applies to a sub-set of WTO Members, *i.e.* those WTO Members that specifically signed the GPA or that have subsequently acceded to the Agreement. The 15 Parties to the GPA are: Armenia,

[18] See the Annual Growth Survey 2012, COM(2011) 815 final, at page 5.

Canada, the European Union (and its 27 Member States -- Austria, Belgium, Bulgaria, Czech Republic, Cyprus, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom), Hong Kong China, Iceland, Israel, Japan, the Republic of Korea, Liechtenstein, the Netherlands with respect to Aruba, Norway, Singapore, Switzerland, Taiwan (Chinese Taipei), and the United States. Several countries, including China, Jordan and Moldova, are currently negotiating accession to the GPA.

On 30 March, 2012, the GPA Parties adopted a revision of the GPA, which expanded the scope of the agreement in an unprecedented way. The revised Agreement also includes a significant improvement of the text of the Agreement by modernizing the text to reflect current procurement practices and clarifying its obligations. The negotiations have resulted in a significant extension of the coverage of the Agreement (which will be effective after the entry into force of the revised Agreement). These gains in market access have been provisionally estimated by the Secretariat as in the range of $80-100 billion annually. They result from lower thresholds and additions of new entities and sectors to the existing Parties' current Appendix I Annexes. For example, one Party has agreed to cover all of its provinces and territories. The other Parties to the Agreement have together added at least two hundred additional entities to be included in their schedules. Three major Parties will provide new coverage of so-called "build-operate-transfer" agreements (BOTs). Also, additional services coverage has been added by almost all Parties, and three Parties have agreed to reduce some of their thresholds.

Procurement, however, is not only regulated by the GPA: to the contrary, GPA and non-GPA countries have engaged in extensive bilateral negotiations on procurement, which resulted in a broader opening through regional trade agreements (RTAs), which has been found to go way beyond the GPA coverage in a recent study commissioned by the OECD (2013). Table 1 below shows the extent of coverage of RTAs including both GPA and non-GPA countries, compared to the coverage of the GPA. The result is that regional trade agreements have achieved significantly greater openness compared to the GPA, even if the latter, in its 2012 revision, is showing an encouraging potential for *de jure* openness in global trade. This, in turn, means that **even if one relies exclusively on *de jure* commitments, GPA is not a fully reliable measure of procurement openness**.

Table 1 – Summary of RTAs committments

	Full	Partial	Unbound
All RTAs (130 commitments)	53.4%	3.1%	43.5%
RTAs between GPA parties (33 commitments)	24.2%	5.8%	70.1%
RTAs between a GPA party and a non-GPA party (80 commitments)	61.1%	2.2%	36.6%
RTAs between non-GPA parties (17 commitments)	73.8%	2.2%	24.0%
GPA commitments under the GPA 2012 (reciprocity adjusted)	25,3%	5.1%	69.5%

Source: Ueno (2013)

Also the European Union might be able to secure more opening of procurement through free trade agreement and association agreements with third countries in the months to come. In particular, negotiations with Canada, China and the United States are likely to bring more reciprocal access to procurement markets, if negotiations will be successful. However, all will depend on how negotiations will be conducted, the relative bargaining strength of the parties involved, and the overall macroeconomic fundamentals of the countries at the table. In the proposal under analysis, the European Commission seems to believe that its GPA commitments have already gone much further than what all other countries have offered, and consequently this will weaken the Commission's position at the negotiations table, since there is not much that the EU can offer as "bargaining chip" to trigger significant reciprocal offers by large trading partners.

How should openness of public procurement be measured?

The Commission's proposal critically depends on one initial assumption: the EU has opened its procurement market much more than its large trading partners, since it has committed to open its procurement markets in the GPA much more than other countries or blocs. However, the measure of openness selected by the European Commission is not convincing, and has been heavily criticized in the literature. The main findings that can be reported from the existing literature in this respect suggest that the European Commission is right when it claims that no other country has committed to open *de jure* its procurement as the EU has done. Table 2 below (second column from the left), developed by Woolcock, summarizes the evidence brought by the Commission to support this statement.

Table 2 – The Commission's estimates of the openness of public procurement markets

	Size of PP markets covered [a]	de jure commit-ments (%) [b]	de facto [c] commitments (%)		Preferential trade agreements between the EU's trading partners and the EU
			EU [d]	EU's partners	
	1	2	3	4	5
Parties to the 1995 Government Procurement Agreement					
EU	370	85	--	--	
USA [e]	559	32	46	47	ongoing joint study
Japan	96	28	70	72	ongoing negotiations
Canada	59	16	10	40	ongoing negotiations
Korea	25	65	82	80	PTA implemented
Israel	2	75	na	75	PTA implemented
Other countries					
Mexico [f]	20	75	na	92	PTA implemented
China	83	0	--	24	no PTA under consideration
Russia	18	0	--	56	no PTA under consideration
India	19	0	--	70	ongoing negotiations
Brazil	42	0	--	38	ongoing negotiations with Mercosur
Turkey	24	0	--	25	PTA does not cover public procurement
Australia	20	0	--	63	no PTA under consideration
Total non EU	967	25	18	na	

Source: Messerlin (2013) on data from the Commission IA document

However, there are at least four major reasons why the Commission might have miscalculated the relative degree of openness of the EU procurement markets:

- The GPA update (agreed at the time in which the Commission was completing its Impact Assessment) has seen the expansion of the commitments offered by certain countries, thus reducing the imbalances reported by the Commission ;

- As recalled recently by Messerlin and Miraudot (2012), during the negotiations on an improved Government Procurement Agreement (December 2011) all countries have agreed that existing data on GPA commitments are so bad that they require a huge effort to improve them (Anderson 2012). Indeed, they are in such a pitiful state that it is impossible to reconcile them (Anderson et al. 2011).
- A measure of openness based on GPA commitments does not make sense as it focuses on a subset of all procurement markets, and on one single instrument for opening such markets. For example, RTAs and FTAs signed (or pending) by the EU may well go beyond existing GPA commitments.

- *De jure* commitments are normally totally different from the *de facto* openness of a given domestic procurement market[19]. Existing literature observes that the level of openness of EU markets is by no means greater than that of large trading partners, including some of the non-GPA countries. Table 2 above shows that the level of *de facto* openness of countries such as Mexico, Russia, India, Korea and even China is broadly comparable to that of the EU.

The latter finding is perhaps the most relevant for what concerns the Impact Assessment document of the European Commission, as it directly affects the problem definition offered by the Commission services. In particular, the availability of the World Input Output Database (Timmers 2012), an unprecedented, detailed source of data on international trade has made it possible to calculate with a certain degree of accuracy the penetration ratios of major economies around the world. Figure 4 below shows the degree of openness (measured as the share of imports in public demand) of certain countries and the GDP of those countries in 2008 based on IMF data. The overall result shows that the degree of openness of the EU27 and also that of large EU economies like France or Germany is below that of China. The EU27 looks more open than the three largest EU member states, except the UK. And most importantly, the EU27 and the US are significantly less open than the East Asian economies – China, Japan, Korea, and Taiwan – targeted by EU and US pressures in the past couple of years.

In other words, as also observed by Woolcock (2012) in his report for the European Parliament on "Public procurement in international trade", it cannot be claimed that EU

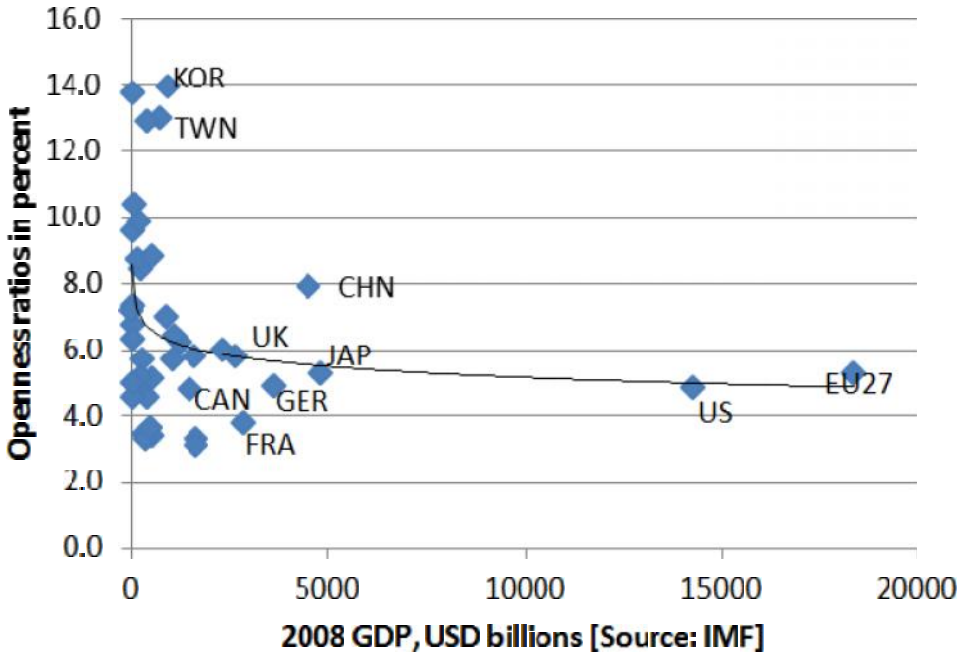
[19] A market is considered in the IA document as open *de facto* if "a country does not apply protectionist measures in the public procurement markets that are not open *de jure*" [Annex 3, methodological box 4 of the IA document]. The *de facto* openness ratio is measured by the percentage share of the value of the markets considered as open *de facto* in the total value of public procurement markets above the GPA thresholds.

procurement markets are significantly more open than other markets in Europe's largest trading partners. The EC has wrongly used data referred mostly to intra-EU trade (apprx 60% of the total). This by itself undermines most of the rationale used by the Commission in the remainder of its IA document.

For example:

- The "leverage" effect claimed by the EC might be over-rated since the EC would not be closing a previously very open set of markets. Since trading partners would not perceive this as a loss of past opportunities, they might not be significantly affected in terms of incentives to negotiate.
- The weakness of the leverage effects might nonetheless lead trading partners to face the "announcement effect" of the new EU regulation, and as such decide to retaliate. As convincingly demonstrated by Woolcock (2012), past experience shows that the likelihood of retaliation (whether simple or boycott-like) is high. In addition, when it comes to China, present behaviour suggests that retaliation is more than likely, possibly across sectors (and China buys, for example, a lot of cars).

Figure 4 – Openness v. GDP



Source: Timmers (2002)

The Commission's stance is partly explained in methodological terms, and partly by clarifying the difference between *de jure* and *de facto* openness. For what concerns methodology, Messerlin and Miraudot (2012a, 2012b) consider that the European Commission should not have taken into account its own intra-EU trade when observing the level of openness of the EU economy. For example, table 3 below shows the openness ratios for selected countries, including the EU27 (only openness to extra-EU trade) and the EU2 (France and Germany combined, only related to extra-EU trade).

For what concerns the difference between *de jure* and *de facto* openness, the difference is easily explained. Even if a market has been officially committed in GPA or in any regional or bilateral free trade agreement, this does not at all imply that foreign companies will have an easy life bidding to be awarded the good or service. In some instances, the design of the public call for tender is tailored to the needs of a national company, or the contracting authority might require certain standards or certifications that only certain companies, domestic or regional, can easily offer. In other cases, there might be direct or indirect pressures on contracting entities to prefer national companies. All in all, there seems to be a myriad ways for contracting entities to keep preferring national champions or simply domestic companies, including SMEs, even if the procurement market at hand is officially committed under the GPA.

Table 3 – openness ratios, selected countries

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Australia	5.1	5.0	5.4	5.4	5.9	5.9	5.8	6.1	5.9	5.9	6.0	5.9	6.2	5.7	5.3
Brazil	2.1	2.0	2.1	2.1	2.7	3.1	3.5	3.5	3.3	3.3	3.1	2.9	3.0	3.3	2.8
Canada	4.2	4.3	4.6	4.9	5.1	5.1	5.0	4.9	4.7	4.7	4.9	4.6	4.6	4.8	4.8
China	3.8	3.1	3.3	2.8	3.0	3.4	3.3	3.6	5.5	5.5	5.6	5.7	5.2	7.9	6.1
EU27 extra	2.6	2.7	2.8	2.7	2.8	3.6	3.7	3.5	3.7	3.7	4.2	4.6	4.5	5.3	4.5
EU2 extra	2.2	2.2	2.4	2.3	2.3	2.8	3.1	2.9	2.8	3.0	3.4	3.8	3.9	4.3	3.5
India	4.2	4.4	4.0	4.4	4.5	4.4	4.0	3.5	4.6	4.6	5.8	6.3	6.3	6.2	5.7
Indonesia	7.9	7.8	7.9	13.9	9.3	11.4	11.6	9.5	9.9	9.9	10.6	8.9	8.8	8.8	6.1
Japan	1.9	2.2	2.3	2.1	2.0	2.3	2.3	2.4	2.8	2.8	3.2	3.8	4.2	5.3	3.5
Korea	7.5	7.5	8.4	8.1	7.7	9.6	9.3	8.9	9.7	9.7	9.9	9.9	10.2	13.9	11.2
Mexico	4.8	4.9	5.2	5.1	4.9	5.2	4.9	4.5	5.6	5.6	5.8	5.9	6.3	6.4	5.7
Russia	3.3	3.5	3.6	4.6	6.2	5.3	4.7	4.2	3.7	3.7	3.8	3.3	3.1	3.1	2.5
Taiwan	9.9	10.1	10.8	11.9	10.7	10.5	10.2	11.3	12.4	12.4	11.9	12.9	13.5	12.9	11.9
Turkey	5.4	7.3	6.5	5.2	4.4	5.8	7.2	8.3	8.8	8.8	9.5	11.3	10.9	13.0	9.5
United Stat	2.7	2.8	2.9	2.8	3.0	3.6	3.5	3.3	4.0	4.0	4.4	4.3	4.4	4.8	3.7
Rest of Wor	6.4	6.8	6.9	6.9	6.7	7.1	7.2	7.9	8.8	8.8	9.4	9.1	9.1	10.1	8.3
World	4.2	4.5	4.6	4.6	4.6	5.1	5.2	5.2	6.0	6.0	6.4	6.7	6.8	7.6	6.3

Source: World Input-Output Database 2012; Messerlin and Miroudot (2012a)

Main findings of chapter 2

- **The EU is the largest trade bloc in the world, but emerging powers are eroding its primacy very quickly**, as globalization is shifting production and investment to emerging economies such as China and Brazil. As a result, the size of procurement markets is not as imbalanced as it used to be only a few years ago.
- **Concerns about lack of participation and official commitment to openness in the GPA have some merit** in light of the recently reported increase in protectionist measures in both developed and emerging economies.
- **However, the Commission might be overstating this problem for several reasons**: (i) the EU is not as open *de facto* as it claims to be *de jure*; (ii) countries such as China, Japan and Korea feature a level of *de facto* openness that is very similar to that of the EU27; (iii) the GPA revision in March 2012 has seen a significant expansion of commitments; and (iv) regional and bilateral trade agreements, including the ones that the EU is negotiating or

about to start negotiating (e.g. the TTIP) can significantly increase procurement openness in the coming years.

- **Even if one considers only *de jure* openness as the relevant measure, GPA commitments would be a very imperfect proxy**, as internationally recognized at governmental level.
- **This description of the *status quo* bears very important consequences for the Commission's IA document**, including the overall problem definition, the assessment of the EU's bargaining power and average potential, and the assessment of the impacts associated with the various options.

3. Analysis of the impact assessment document

Based on the problems identified and discussed in section 2, this Section provides an assessment of the Commission's IA document. In particular, the assessment is based on a list of eight issues submitted to the author of this report by the Impact Assessment Directorate of the European Parliament. In responding to this request, some of the issues have been broken down into two sub-items, leading to a final list of ten statements, which can be considered as covering, altogether, the request received by the European Parliament.

3.1. The IA document does not properly evaluate the openness of the EU public procurement markets compared to large trading partners

The main pillar that sustains the rationale built by the European Commission in the IA document is the fact that EU public procurement markets are way more open than those of the EU27's large trading partners. However, as observed in Section 2 above, this statement is far from correct due to both methodological flaws in the Commission's argument, and to the difference between *de jure* and *de facto* openness of public procurement. More in detail:

- From a methodological viewpoint, GPA commitments are a very incomplete proxy for procurement openness, since non-GPA countries can nonetheless accept bids and award public contracts to foreign companies, and also since both GPA and non-GPA countries have committed a much larger amount of procurement under RTAs and FTAs than they did within the GPA (which, anyway, has seen a significant expansion of coverage in March 2012). In addition, the use of GPA commitments as evidence of *de jure* openness has been criticized by GPA-participating governments due to the incompleteness of the data available.

- When one looks at the *de facto* openness of individual countries, evidence from the World Input-Output Database suggests that the EU27 are not significantly more open than their largest trading partners in terms of actual contracts won. To the contrary, countries like Korea and China seem more open than large European economies in terms of penetration ratios. Of course, the *de jure* perspective is very important for international trade negotiations, since it reflects the position officially adopted by a given national or regional government and is as such an element of negotiation; however, it is the *de facto* penetration ratio that should be taken as a basis to assess the current leverage potential and the likelihood of retaliation in case of adoption of new

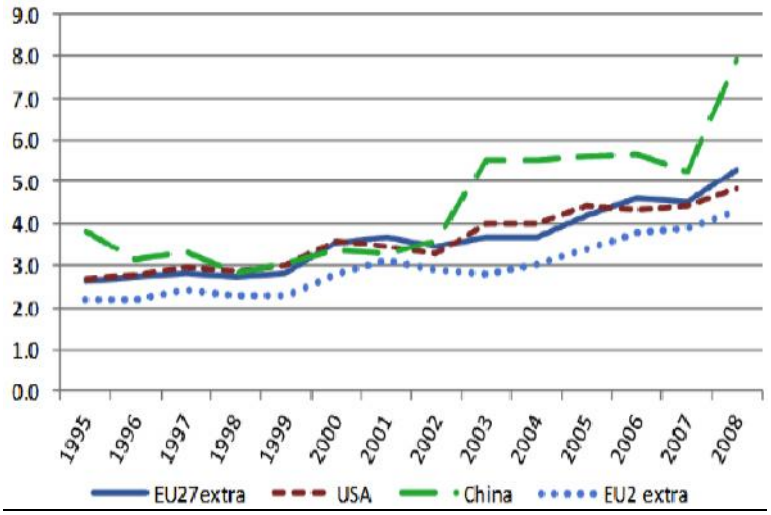
regulatory instruments by the European Commission. Put more simply: if Chinese businesses are not currently in the position to penetrate easily all the procurement markets that are *de jure* committed, they will not consider full openness as a starting point of the negotiation. In this respect, if the European Commission perceives a lack of leverage in international negotiations, the reason would probably have to be found in the behaviour of Member States governments rather than that of non-EU countries. The problem – as will be stated below – becomes then one of subsidiarity, rather than plurilateral trade talks.

3.2. The factual and legal openness of procurement markets is not fully addressed by the IA document

As already recalled above, even if a market has been officially committed in GPA or in any regional or bilateral free trade agreement, this does not at all imply that foreign companies will have an easy life bidding to be awarded the good or service. In some instances, the design of the public tender is tailored to the needs of a national company, or the tenderer might require certain standards or certifications that only certain companies, domestic or regional, can easily offer. In other cases, there might be direct or indirect pressures on contracting entities to prefer national companies. All in all, there seems to be a myriad ways for contracting entities to keep preferring national champions or simply domestic companies, including SMEs, even if the procurement market at hand is officially committed under the GPA.

Figure 5 below shows the relative de facto openness of France and Germany combined (the EU2), the EU27, the US and China (data are a subset of those shown in Table 3 above), which shows that, especially after 2001, China has constantly been more open than the United States and the EU27, whereas the Eu2 have been always less open than the other regions or countries included in the figure.

Figure 5 – Relative de facto openness, selected countries/regions



Source: WIOD 2012 plus authors' calculations.
Note: the EU extra is the openness ratio of France and Germany combined

The European Commission seems to acknowledge the difference between full and partial openness in its Annex 7, where it reports a modified calculation of *de facto* openness. However, some of the estimates appear to be in contradiction with the literature (for example, China's procurement market is considered to be fully closed also *de facto*). To be sure even the Commission's estimate acknowledge that certain trading partners such as Japan and Korea are remarkably open.

3.3. The incomplete problem definition leads the European Commission to mis-measure the potential for market opening in third countries

The European Commission implies, in the IA document, that large trading partners have limited incentives to open up their procurement markets since the EU has already almost fully opened its own. Accordingly, there is no additional commitment that the EU can offer to trigger reciprocal concessions. Our findings based on the literature reported in Sections 2, 3.1 and 3.2 above show that this description of reality is flawed in a number of respects. This being the case, a number of conclusions can be drawn for what concerns the potential for market opening in third countries.

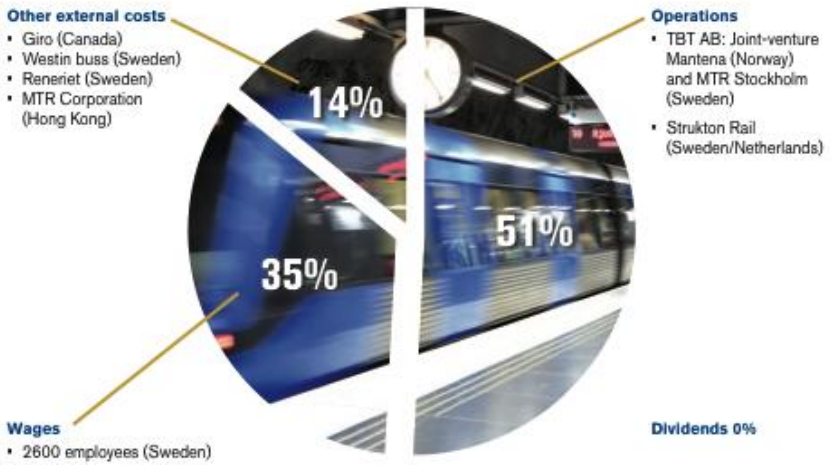
- First, the European Commission declares in the IA document that at least 50% of uncommitted Public Procurement in its 12 largest trading partners is not open, leading to 12 billion Euros of untapped exports and 180,000 corresponding jobs. However, Annex 8 to the IA document reveals that in most cases countries apply only partial limitations or constraints to public offering (e.g. 15% local content requirements, 2.5% price differentials, etc.): these measures cannot be understood as fully blocking the markets in which they apply, although of course they can become hurdles to a full participation of EU businesses.

- Second, and relatedly, it must be considered that businesses that bid for the provision of a certain service rarely cover the whole supply chain of that given service (e.g. rail, or construction, which seem to be among the most frequently closed markets in main trading partners of the EU). Especially in the era of global value chains, delocalization of production and reliance on local suppliers would not always entirely disrupt the business case of large EU bidders – at the same time, they could be damaging for some European SMEs or large companies that would have otherwise participated to the supply of the service or good at hand. This has recently been fully confirmed by the fact that a number of German SMEs have demonstrated against the proposed imposition of an anti-dumping EU tariff on the Chinese solar panels (see also below, Section 3.5).

- Third, and importantly, it must be acknowledged that it will anyway take years before emerging markets are fully opened *de facto*. Accordingly, the untapped exports and associated jobs must be discounted based on time and also on the likelihood that *de facto* openness will indeed occur. This makes the European Commission's estimate a bit shaky, and worthy of a re-assessment.

It is worth bringing the example of the largest civil procurement contract won in 2009 (approx 3 billion Euros), which Swedish authorities awarded by the regional public transportation corporation in Stockholm to the Hong Kong-based company MTR Corporation Limited. Not only had MTR established a local affiliate MTR Stockholm (a subsidiary of MTR Europe involved in the London Overground system); overall, the value generated by the contract was divided between Sweden, Canada, Norway, Hong Kong and the Netherlands. In addition, 2,600 jobs created remained Swedish, notwithstanding the foreign origin of the winning bidder[20].

Figure 6 – Economic value of the contract for underground operations, 2010



Source: Kommerskollegium/Swedish National Board of Trade (2011)

3.4. As a consequence, also the impact on job creation appears over-stated

Our analysis of current trends in global trade and the standing Commission proposal to create a new EU instrument to close certain procurement markets vis-à-vis certain or all trading partner does not support the Commission's estimate in terms of jobs created. The potential for job creation as identified by the Commission is highly dependent on the following chain of effects:

- The European Commission is indeed able to trigger a "reciprocal commitment" which leads to a full opening of procurement markets (*de jure*);
- The *de jure* commitment is translated swiftly into *de facto* openness (very unlikely as *de facto* trading partners are already reasonably open;

[20] The subcontractor responsible for train maintenance (approximately 54 million euros) is a joint venture between MTR and the Norway based company Mantena. The rail service subcontractor is the Dutch company Strukton Rail. The main IT-solution provider is the Canada based company GIRO. The stand-by transportation subcontractor is the Swedish company Westin Buss. The sanitation subcontractor is Swedish-based Reneriet.

- The *de facto* openness is associated with a good success rate of EU companies in foreign procurement over time (despite growing competition from businesses originating in emerging economies, sometimes state-subsidized);
- The number of jobs created follows the same pattern as the downstream jobs associated with the production of extra-EU exports (developed by Eurostat/JRC), which in 2007 showed that the whole of EU sales to the rest of the world (worth around 1,382 bn Euros) were associated with 21.4 million jobs EU-wide (see IA Document, Annex 3). Accordingly, the estimate covers both the jobs associated with the production of the exported goods and services and all employment in downstream sectors that are embodied in sales to foreign markets. The underlying assumption is thus that for foreign procurement the number of jobs created in the country of origin would follow a similar proportion (which is not necessarily the case).

As a result, the jobs/export ratio estimated by the Commission appears tentative at best, and likely to be over-estimated. It must also be acknowledged though, that the amount of jobs that would be created, and the amount of untapped exports do not play a decisive role in the IA document, and in particular in the choice between types of legislative instruments: the European Commission uses a very simplistic table, which describes the level of (*de jure*) openness of a country as full ("1"), partial ("0,5") and none ("0").

This level of approximation, after all, is common throughout the report. For example, when the impacts of the various options are compared (table 14), some rather odd results emerge. All options have the same potential of stimulating exports and jobs, even if 3A and 4 lead to much worse retaliation potential by third countries. Option 3B is considered the one that creates the best incentives for trading partners to open their procurement markets, whereas option 6 strengthens the level playing field more than others (but all options 3 and 4 have a positive effect, though it is unclear why). Basically the table also reveals very limited impacts, if any, on public finances, and a very important contribution of Option 3B to the consistency of EU trade policy and the respect of international agreements: it is not very clear, however, how this would eventually occur.

3.5. In the era of global value chains, banning foreign bids might mean damaging EU SMEs

The Commission IA document states that the current situation might hamper the capability of EU SMEs to internationalize their activities. The impact on SMEs has thus been assessed only limited to their potential for internationalization. However, the conclusions drawn by the IA document must be taken with caution. First, normally only very highly specialized SMEs make it to foreign markets, and normally not through public procurement. Second, SMEs have significant problems of access to public procurement also in the EU, as testified by numerous reports published by the European Commission. Third, if anything, SMEs could find it profitable to be involved as local suppliers in bids placed by foreign companies in EU procurement markets. The example of the Swedish underground above is already telling; in addition, one report by a

consultancy firm (Prognos) and several statements by medium-sized German companies point at a potential loss of up to 200,000 jobs as a result of the proposed tariff[21].
In this respect, banning foreign bids on the basis of the fact that 51% of the ownership of the bidder is not European could end up depriving certain SMEs of attractive business opportunities. Finally, the impact on SMEs should have taken into account administrative burden and compliance costs in a specific way: for example, for those options that entail the production of certificates of origin, the related administrative burden would disproportionately fall on SMEs. We will get back to this issue in Section 3.8 below.

Finally, the IA document should, in the analysis of the baseline, adequately account for the existence of a work program under the revised GPA, which provides that the parties that maintain in their commitments specific provisions on SMEs, including set-asides, need to notify the Committee on Government Procurement of such measures and policies. Also, the Committee will conduct SME survey to identify best practices and encourage the parties to review other measures with a view to eliminating them or applying them to the SMEs of the other party. It is expected that the issue of set-asides and its possible trade-distorting nature as well as the issue of SMEs participation will be addressed through these transparency exercises. Similar provisions have been introduced in RTAs and FTAs, and could become a key requirement for the EU to engage in trade talks with the US, China and Canada in the coming months.

3.6. The flawed problem definition leads the Commission services to mis-assess the risk of retaliation and the potential for leverage creation

The European Commission IA document measures the potential for retaliation by trading blocs based on two factors: (i) the more an option closes *de jure* a given market to foreign bidders, the higher the risk of retaliation; and (ii) the more the decision to close a market affects offensive interests of a trading partner, the higher the risk of retaliation, and the harsher the retaliation. These are intuitively meaningful assumptions, although it must be recalled that, since the current level of *de facto* openness of EU markets is not as significant as the level of *de jure* openness, the reason to retaliate for trading partners would not be as strong as the Commission believes. Rather, it will be the "shock effect" of the announcement that will lead to a decision to retaliate: the United States, for example, have consistently shown their willingness to retaliate even against the EU (*e.g.* when Article 58 of Directive 2004/17 on utilities public procurement procedures was adopted

[21] See the Prognos report here. Among others, the Alliance for Affordable Solar Energy (AFASE) carried out a symbolic funeral march in front of the Berlaymont building on May 24, 2013 to commemorate the more than 200,000 jobs that are expected to be lost as a direct consequence of the European Commission's proposed duties. In the United States, a similar issue emerged in 2012: research-based consultancy The Brattle Group published a report in which a 50% tariff was expected to discourage the majority of Chinese imports from the US and result in a "net" job loss of 15,000 to 50,000 workers (even accounting for US production gains). In reality the tariffs that were imposed in the US were mostly lower (approximately 30%).

by EU institutions). Evidence of retaliation is over-abundant in recent times, especially between the US, the EU and China. For example:

- In March 2013 the US Congress passed legislation banning Chinese IT hardware manufacturers (such as Huawei, ZTE and Lenovo) from public procurement, absent a thorough, burdensome risk assessment;
- Karel De Gucht, the European commissioner for trade, warned China on 15 May 2013 that the European Commission is prepared to impose sanctions on two telecom equipment-makers, Huawei and ZTE Corp, if it concludes that they received illegal subsidies or dumped their products on the European market.
- The European Commission will decide on 6 June 2013 the imposition of temporary punitive tariffs on Chinese producers of solar panels, an industry that exported to the EU €21 billion of goods in 2011. Also, permanent anti-dumping tariffs are being imposed since April 2013 against Chinese producers of ceramics and stoneware.
- China filed a case with the WTO in November last year accusing some EU member states of favouring EU producers of solar-energy equipment. But retaliation could also look at other sectors, and notably the European wine industry.

In other words, assuming "no retaliation" or "light retaliation" today is purely utopistic, as trade talks have become incandescent[22]. Against this background, the European Commission seems ready to bear the risk of retaliation, assuming that "simple retaliation" will be the most likely scenario. No evidence is shown to prove that this will be the case, and the industry seems more oriented towards believing in a harsh response by trade partners.

Of course, retaliation is one of the possible reactions of trading partners, should the European Commission decide to close down certain procurement markets as an own initiative or following a request by a Member State. The other possibility is that, hit in core offensive interests, trading partners will decide to surrender and lift the obstacles to entry of EU businesses in their markets. This scenario corresponds to what the European Commission calls "high leverage": the problem with this scenario is that the leverage exerted by the EU in international trade negotiations is doomed to shrink as the relative shares of public procurement of the EU and its trading partners are being reshuffled. As observed by Messerlin and Miroudot (2012), "[t]he threat of closing EU markets assumes a *rapport de force*. The credibility of such a threat is already gone: the combined French and German public demand, which was almost eight times larger than China's public demand in 1995 and three times in 2000, was only 1.3 times larger in 2009".

In other words, and from a more game-theoretical perspective, it is possible to state that the extent of the leverage effect depends very much on each of the parties' next best alternative, or – using the jargon introduced in game theory by Harvard Business School

[22] This is not exclusive of the EU of course. For example, in 2009 China responded to the 35 percent tariff on imports of Chinese tyres imposed by the US, imposing countervailing duties of 31 percent on imports of chicken from the US, later increased to 105 percent. See Trade Wars Brewing in Economic Malaise by A. Faoila and L. Montgomery in the Washington Post, May 15th 2009.

scholars – the parties' BATNA ("Best Alternative to Negotiated Agreement", see Ayres and Nalebuff 1997)[23]. At a first level of approximation, this implies that the more a trading partner has the option of accessing other procurement markets, and the smaller the penetration ratio of that country into the EU procurement market, the lower will be the leverage that any EU decision to shut down markets will have.
Based on the above, it seems likely that the European Commission is under-estimating the likelihood and extent of retaliation, and is over-estimating its leverage potential vis-à-vs third countries: this, all in all, leads to a significant misperception of the likely impacts of legislative options aimed at closing *de jure* – whether by default or upon request – certain markets that so far have been, at least *de jure*, open.

3.7. Administrative burdens are tentatively assessed, but this is unlikely to be a major problem for this IA document

The IA document assesses the extent to which alternative options would increase administrative burdens based on the Standard Cost Model, and thus broadly in line with the requirements of the IA guidelines (Annex 10). More in detail:

- The cost of certificates of origin was taken from the impact assessment on Rules of origin for the Generalised System of Preferences (GSP), where they were assumed to cost 5 EUR.
- For notifications, the cost incurred has been calculated on the basis of an estimation provided by contracting authorities themselves in the consultation, where most respondents indicated half a day in EFT (thus 240 minutes).
- Cost of labour: a value of 22 €/hour was adopted as an average EU salary.
- The cost of the procedure has been calculated on the basis of the number of procurement procedures impacted by the option, and if the obligation fell on the winner or on all the participants (in which case, we used 5 bidders, which happens to be the average number of bidders).

Once the procedures have been defined in the alternative policy options, the SCM is correctly applied: however, the assessment is incomplete: (i) burden measures should have been calculated for both the bidders that have to handle the notification, and public contracting entities (the EU SCM applies also to public administrations); (ii) a more careful estimate of the time spent assessing whether a given bid is to be considered foreign or national, abnormally low, or not, etc. should have been taken into account; and (iii) overall, the procurement rules of origin would create additional costs for all bidders, and thus also for EU bidders.

In any event, the magnitude of administrative burdens is not such that any different assumption, or even a more complete assessment of the burden, would tilt the balance in favour of any of the alternative options, even in the case of option 3c, which seems the most burdensome of all.

[23] Ayres, I. and B. J. Nalebuff (1997), 'Common Knowledge As A Barrier To Negotiation'. Yale ICF Working Paper No. 97-01.

3.8. The 5 million Euro threshold is not discussed in the IA document

An important aspect of the European Commission's proposal is the selection of a threshold value, based on which only tenders over 5 million Euros would be subject to the new regime. More in detail, Article 6 of the proposed regulation sets out the conditions under which the Commission may approve that individual contracting authorities/entities exclude tenders from tendering procedures, where the value of non-covered goods and services exceeds 50% of the total value of goods or services included in the tender for contracts with an estimated value equal or above €5 million. According to the publication of notices in the Official Journal (TED, Tenders European Daily), only 7% of all contracts published in the Official Journal have a value above EUR 5 million. However, those contracts represent 61% of the value of the whole EU public procurement market.

The Commission estimates that it would receive each year a maximum of 35-45 notices. For contracts with an estimated value equal or above EUR 5 million the Commission should take a decision on the exclusion. The Commission should, for all contracts, approve the intended exclusion when the goods and services concerned are subject to a market access reservation under the EU international agreements on public procurement. Where such an agreement does not exist, the Commission shall approve the exclusion where the third country maintains restrictive procurement measures leading to a lack of substantial reciprocity [*emphasis added*] in market opening between the Union and the third country concerned. The proposal also specifies that "when assessing whether a lack of substantial reciprocity exists, the Commission shall examine, to what degree public procurement laws of the country concerned ensure transparency in line with international standards in the field of public procurement and preclude any discrimination against Union goods, services and economic operators. Moreover it shall examine to what degree public authorities and/or individual procuring entities maintain or adopt discriminatory practices on Union goods, services and economic operators". However, the reciprocity assessment does not seem to entail an assessment of the EU's own level of substantial openness. Nor are the administrative burdens associated with all these procedures fully accounted for in the IA document.

But most importantly, the choice of the 5 million Euro threshold is purely arbitrary and not motivated in the IA document. It is not clear why the European Commission decided not to reach at least 80% of all procurement, and what would have been the corresponding costs.

3.9. The IA document downplays the emerging protectionist measures (de jure and de facto) being taken by some EU Member States

As already observed, the IA document mentions the fact that, in light of the current, unsatisfactory lack of leverage of the EU institutions in trade agreements on public procurement, some Member States are taking autonomous initiatives to protect their economies. Although the Commission reports that there is limited information available

on the exact use of these provisions in the relevant Member States, it mentions cases in Austria (where equal treatment is only conferred on the basis of international agreements and contracting authorities have posed questions to the *Bundeskanzleramt* to ask about the eligibility of Turkish, Indian, Chinese, Ukrainian, and Bielorussian firms, which may have discriminated against them); Italy (where courts have ruled against the participation of Chinese and Australian firms until an international agreement exists between the EU and China/Australia in the area of public procurement); Spain (request of certificates of reciprocity in at least one instance) and the UK (where bidders from third countries with no procurement agreement with the EU have been denied certain remedies.

That said, it seems that these are more isolated cases than real cases of legislative measures that would be incompatible with the status of EU member. As already recalled several times throughout this report, countries have a number of possibilities to resort to protectionism, of which *de jure* closure of procurement seems perhaps the least advisable, and the least likely. As a matter of fact, existing data on trade continue to include EU Member States and the EU region among those countries that manage to limit their import penetration ratio in government procurement. Once again, the *de facto* v. *de jure* difference leads the Commission to understate the extent to which public procurement markets in the EU27 are, themselves, *de facto* difficult to conquer for non-EU bidders.

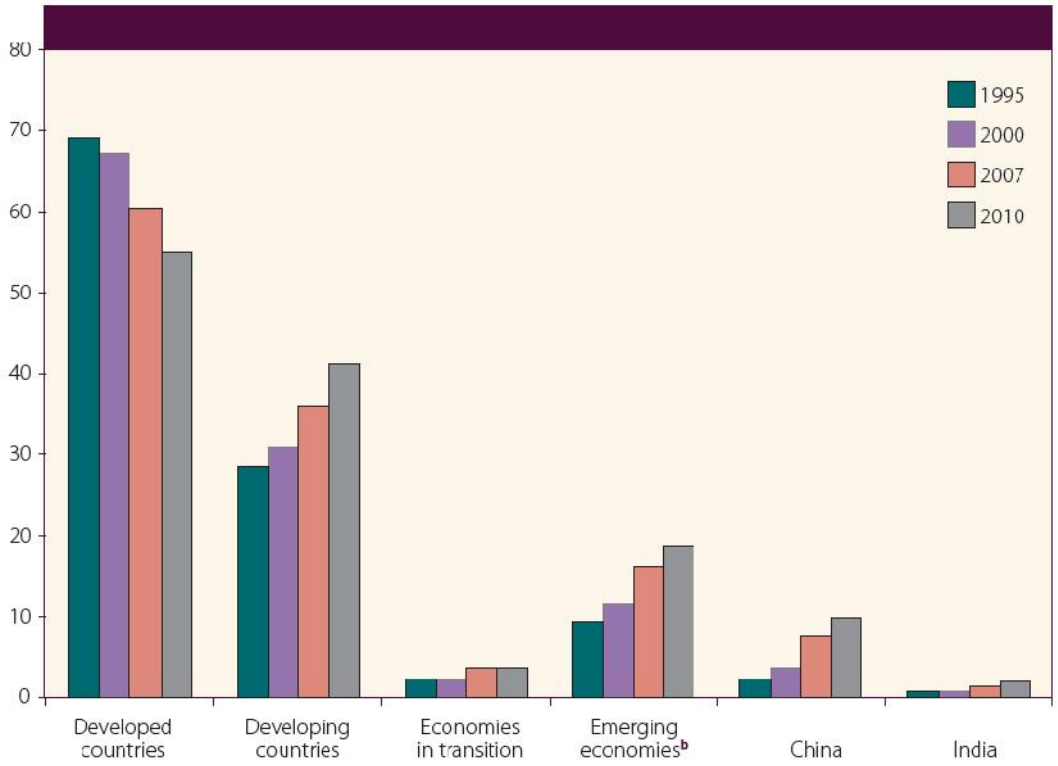
3.10. Shifting global trade shares, subsidiarity and taxpayers: the "elephants in the room"

In addition to the issues selected by the European Parliament for analysis in this report, at least three other issues are worth being mentioned in order to complete the analysis of the IA document: subsidiarity and the impact on citizens.

- First, the baseline option is indeed described as the *status quo*, not as a future-looking scenario. One major problem with the European Commission's IA document is that it approaches global trade in a static way: figure 7 below shows the diverging trends in global trade shares between developed and emerging economies. The assessment of the 12 billion Euros of trade that is untapped due to the limited international openness of certain countries reflects this static approach (see above, Section 3.4 for a more detailed analysis of the underlying assumptions). The fact that the baseline does not carry an assessment of how the situation is likely to change in the coming years is a quite serious problem. The baseline option, in addition, hides a number of internal market problems faced by the European Commission in public procurement. The lack of leverage of the Commission seems, as suggested recently by the Swedish Board of Trade, more an internal market problem than a trade problem (Kommerskollegium, 2011). Among the various issues on the table, there seems to be important margins for improving EU legislation in a number of fields, including Art. 58 and its possible strengthening that constitutes one of the options under scrutiny in this IA. In addition, the Commission mentioned the extreme complexity of EU international procurement commitments for procuring entities at national and local level, to an extent that many authorities responding to the consultation mistakenly declared that their contracts were not covered by the GPA. This can be related to a situation of general legal uncertainty for foreign companies that participate to

domestic procurement procedures, which might hamper their willingness to participate. All these aspects are extremely important, in particular for EU SMEs.

Figure 7 – evolution of shares of world merchandise trade, 1995-2010



Source: UN/DESA (2012)

- Second, subsidiarity is discarded as not relevant by the IA document: however, some of the options compared (in particular, Options 3B and 3C) delegate the power to accept/reject offers to the European Commission rather than contracting authorities: this cannot be overlooked as it shifts responsibility to the European Commission for decisions that might ultimately be very costly for public administrations (reducing competition in public procurement, by excluding what are normally among the cheapest or most cost-effective bids) and ultimately for taxpayers.

- Finally, and more generally, the analysis of the impact of the various options on taxpayers is almost entirely missing, and if anything confined in an annex. The only assessment provided regards the impact of losing one bid. To the contrary, the most important and widely acknowledged reason to advocate free trade and open public procurement is the benefits that this brings to citizens and administrations in terms of better quality and reduced costs, allowing contracting authorities to select among a wider range of competitors. An instrument that sacrifices competition on the altar of international trade negotiations should at least be motivated through an assessment of the cost that this will imply for citizens of those countries that will have to reject foreign bids: citizens that, in all likelihood, will not reap all the benefits connected to their "sacrifice".

Main findings of chapter 3

- **The IA document does not properly evaluate the openness** of the EU public procurement markets compared to large trading partners
- The **factual and legal openness** of procurement markets is not fully addressed by the IA document
- The **incomplete problem definition** leads the European Commission to mis-measure the potential for market opening in third countries
- As a consequence, also the **impact on job creation** appears over-stated
- In the era of global value chains, **banning foreign bids might mean damaging EU SMEs**
- The flawed problem definition leads the Commission services to mis-assess the **risk of retaliation and the potential for leverage** creation
- **Administrative burdens are tentatively assessed**, but this is unlikely to be a major problem for this IA document
- The **5 million Euro threshold** is not discussed in the IA document
- The **IA document downplays the emerging protectionist measures** (de jure and de facto) being taken by some EU Member States
- Three additional elements are worth being highlighted in the IA document: the **baseline is too static** and not future-proof; **subsidiarity** should have been tackled more thoroughly for certain options; and the ultimate **impact of alternative options on administrations and taxpayers** is not fully assessed.

Concluding remarks

The practice of Impact Assessment is a very important achievement of the EU institutions, in particular of the European Commission and also, increasingly, of the European Parliament. The added value of Impact Assessment rests in the fact that administrations are forced to explain the underlying rationale of legislative initiatives, starting from a description of the problem to be addressed, a motivation of the need (and opportunity) to act, and an analysis of possible alternative options that are likely to address successfully the problem at hand, in a way that leads to positive outcomes, often expressed in terms of net social benefits (European Commission 2009, Renda 2012). The fact that the rationale and underlying assumptions are made available to stakeholders, experts and other EU institutions is expected to – and indeed does – increase the quality of the debate especially while legislative proposals are still in the co-decision phase.

This briefing note must be seen as an attempt to contribute to the quality of the debate by evaluating whether the European Commission Impact Assessment on proposed new rules concerning third countries' reciprocal access to EU public procurement contains an accurate definition of the problem, and effectively makes the case for the policy option selected by the European Commission. The main finding is that, although the document is well-structured and very informative, it could be improved in many respects, starting – most notably – from the problem definition, which seems to overstate the existing gap between the level of openness of EU and non-EU procurement markets. And since this gap is one of the founding pillars of the whole Commission initiative, and bears important consequences on the Commission's reasoning around the consequences of the preferred option in terms of future retaliation by non-EU countries and increased leverage potential of the Commission itself, the briefing note calls for a more accurate scrutiny of the problem.

Moreover, besides addressing the eight issues that have been raised by the INTA committee of the European Parliament, this briefing note highlighted some issues that fall outside the scope of the initial requests: these are important issues as they refer to the interpretation of the baseline scenario, to the assessment of subsidiarity, and to the ultimate impact of the proposed rules on taxpayers. Finally, it is suggested that the problem of the Commission's lack of leverage in international negotiations could be approached also, and perhaps interestingly, also from the standpoint of subsidiarity, internal market and overall multi-level coordination in procurement policy in the European Union. Examples of this lack of coordination are widespread: suffice it to observe that the European Commission only has instruments of "moral suasion" available to ensure that Member States gradually shift to "green public procurement" when their contracting entities purchase their products[24].

[24] See Renda et al. (2012), Monitoring the uptake of Green public Procurement in the EU, report for the European Commission DG CLIMA, available at this link.

In conclusion, the findings of this briefing note should not be read as a statement against the Commission's proposal: what is addressed is the logical sequence that brings the Commission to advocate the creation of a new instrument as a consequence of the Commission's reading of the current situation of global trade. Accordingly, it is suggested that the INTA Committee fosters a more accurate reflection on several aspects, with the overall belief that such reflection could help EU institutions devising the right way of tackling the current lack of coordination and leverage in international trade negotiations, and possible ways to strike the balance between the need to secure recovery from the current economic downturn, and the need to continue acting as a champion of open trade at the global level.

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Detailed appraisal
of the European Commission's Impact Assessment

Rules concerning third countries' reciprocal access to EU public procurement

Commission proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries (COM(2012) 124 final)

ANNEX II

Openness, job creation, administrative burdens, SMEs and thresholds

Research paper
by Máté Péter Vincze

Abstract

This briefing paper assesses the method and key findings of the Commission's Impact Assessment of the proposed regulation on access to third-country goods and services to the Union's internal market in public procurement, focusing on the openness of EU public procurement, its benefits, job creation, administrative burdens, SMEs and thresholds. A summary assessment is followed by a detailed assessment of the topics and individual research questions.

AUTHOR
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List of abbreviations

ACP	African, Caribbean and Pacific Group of States
COFOG	Classification of the Functions of Government
CPV	Common Procurement Vocabulary
DG MARKT	Directorate-General Internal Market and Services
EFTA	European Free Trade Area
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
RQE	Revealed Quality Elasticity
SAA	Stabilisation and Association Agreement
SME	Small and medium-sized enterprise
TED	Tenders Electronic Daily, the EU database of public procurement notices
WTO	World Trade Organisation

Introduction

This "briefing for a detailed appraisal of the Impact Assessment on rules concerning third countries' reciprocal access to EU public procurement" has been commissioned by the European Parliament, Directorate on Impact Assessment and European Added Value following a request from the Committee on International trade (INTA).

The objective was to prepare a briefing document on 'Impact Assessment SWD(2012)57 accompanying the *proposal for a regulation establishing rules on the access of third country goods and services to the European Union's internal market in public procurement and procedures supporting negotiations on access of European Union goods and services to the public procurement markets of third countries (COM(2012)124)*', analysing, commenting and possibly complementing it with regard to eight topics:

1. Openness of EU public procurement market
2. Potential benefits of market opening
3. Impact on job creation of the different options
4. Risk of retaliation and leverage creation
5. Administrative burden of assessed options
6. Impact on SMEs
7. Justification of thresholds
8. Existing national legislation restricting access to public procurement markets

In the terms of reference, a set of specific questions were formulated under these topics. This paper first gives a summary assessment of how the above eight topics were discussed in the Impact Assessment and then provides comments and additional information to the individual topics and specific research questions.

Summary assessment

Undoubtedly, **much work has gone into the Impact Assessment**. Extensive research has been undertaken especially with regard to the country-specific commitments under World Trade Organisation's Government Procurement Agreement (GPA) and the factual situation of European market access in 22 key sectors in 13 key trading partners (partly "covered", partly "uncovered" by international agreements). Elaborate models were drawn up to structure information on the current situation and to dimension impacts; and available - scarce – statistics were duly interrogated.

The disadvantage from the reader's perspective is that **the models used in the document are complex, not sufficiently described and thus difficult to follow**. Several Annexes and "methodological boxes" need to be studied to understand what has been done, and the descriptions of the methods are often too short to comprehend, even some gaps were

detected here and there. Although this is not customary in an Impact Assessment exercise, interlinked Excel sheets would have helped to follow up the calculations.

A few impacts were not assessed in detail (on SMEs, working conditions, social and environmental criteria), and the impact of a possible reduction of imports and linked supply chain effects on jobs was apparently left out from the calculations.

Dealing with a very complex topic and lacking detailed and robust data, the Impact Assessment **had to strongly simplify, rely on expert judgement and make assumptions to fill data gaps in the calculations**. The judgements assumptions seem mostly reasonable, although some of them may be contested. However, as the estimated impacts consequently rest to a very high degree on them, a **sensitivity analysis to test the impact of different key assumptions or at least range estimates** would have been warranted**.**

The specific findings in relation to the eight topics – elaborated in detail in subsequent sections - are as follows:

1. Openness of EU public procurement market

The selection of the 22 key sectors for the detailed analysis is reasonable. The method used however cannot be seen as very robust as it only allows for a very broad classification of market openness, and many follow-up assumptions and expert judgements were made to estimate the impact of the policy options.

A detailed review of the *de jure* openness of the EU's public procurement market – and a comparison with its key trading partners - under these 22 sectors is missing. While the Impact Assessment states that the EU's market is *de facto* open, also for "uncovered" goods and services, there are in practice many possible hidden market entry barriers that can make it very difficult for third-country suppliers to access European public procurement.

It was not possible within the boundaries of the assignment to undertake case studies on the openness of public procurement in 5 European capitals and 5 global cities. However, a review of contracts above the EU-thresholds awarded to third-country economic operators in 2011 reveals that these companies could access directly – i.e. not through EU subsidiaries or dealers – only a very small number of contracts (0.2% of all). Contracts won by third country economic operators include a high number of relatively low value purchases of medical equipment and pharmaceuticals from (predominantly Swiss) specialised suppliers, but also high-value procurement of, for instance, rolling stock, fuels, or academic journals (EBSCO from the US). In terms of value, the league table of third countries is led by Switzerland by a wide margin; the United States and Turkey follow.

2. Potential benefits of market opening

Further investigation of the method used needs to be undertaken. Comprehensive statistical data on contracts won by EU companies in third countries is not available; only Japan has disclosed figures within the WTO GPA framework. Data on infrastructure deals can possibly be procured from a fee-based service, and some countries have accessible national databases which might be interrogated (by people with the right languages skills).

3. Impact on job creation of the different options

The impact of the policy options on job creation is directly derived from the expected change in export volumes (new markets and retaliation) and does not account for jobs created in the EU from substituting imports with domestic production. The exact method used is not clear and could not be reproduced. Following the method of the Impact Assessment, import substitution may result in additional jobs in the magnitude of one third or one half of the impacts already calculated (new exports, minus retaliation).

The fixed ratio between export and corresponding job creation (15 jobs for every €1 million additional exports) assumed is however likely to result in overestimation by not taking into account idle capacities; the capital-intensiveness of the key sectors and large supply contracts; high local content. On the other hand, the impacts were only calculated for the 22 key sectors and 12 key trading partners (an additional 50% in new export volumes may be possible).

The assumption that the same level of market opening should be calculated for four options (3A, 3B, 3C and 4) is not unreasonable, but it is of course not possible to give a reliable figure on the extent third countries will effectively open up their public procurement markets during negotiations.

Impacts with regard to working conditions and the respect of social and environmental objectives are only mentioned in the document but they are not properly assessed. The Impact Assessment mentions the possibility that barriers to third country goods and services may undermine the incentive of foreign firms to adopt stricter standards. It is however not clear how strong these impacts could be. Considering that the evolution of standards and enforcement in third countries depend on many other factors, the impact may be negligible. Working conditions in the EU are likely to benefit from the proposal, if bids from foreign companies who aggressively undercut domestic rivals by not offering the same conditions to their employees can more easily be rejected.

4. Risk of retaliation and leverage creation

This topic, not assessed in this briefing, is kept here *pour mémoire* for reasons of congruence with the structure of the questions requested by INTA.

5. Administrative burden of assessed options

The method is not well described and hence difficult to follow. The Impact Assessment calculates with a much higher number of notifications (554 for option 3B) than the explanatory part of the Commission's proposal (34-45 notices per year expected). The administrative burden on companies only calculates with €5 per certification of origin, probably not taking appropriate account of the time and effort preparing these. No one-off administrative costs (setting up new procedures etc.) have been included in the calculations and the obligation to contracting authorities to indicate a possible waiver in the standard forms should also be considered an administrative burden.

6. Impact on SMEs

The Impact Assessment contains very little discussion of the impact of the policy options on SMEs. Overall, European SMEs are likely to benefit mostly from import replacement – i.e. supplying EU clients directly or as consortium partners or subcontractors – rather than securing (high-value) contracts on new export markets. Hence policy options that are linked with larger import replacement (3A and 3C) are the most beneficial for them.

7. Justification of thresholds

The suggested threshold (€5 million) in Article 6 of the legislative proposal - exceeding GPA-thresholds for supplies and services by a wide margin – or optional thresholds have not been assessed in the document. Lower threshold may result in a larger share of imports rejected but probably more retaliation (hence relatively beneficial for domestic-market-oriented European SMEs but negative for exporters: especially SMEs but also large enterprises).

8. Existing national legislation restricting access to public procurement markets

This topic, not assessed in this briefing, is mentioned here *pour mémoire* for reasons of congruence with the structure of the questions requested by INTA.

Openness of EU public procurement market

Q1.1 Has the openness of the EU's public procurement market compared to other trading partners been properly evaluated?

The method used in the document for assessing the openness of public procurement – as all subsequent analysis of impacts – rest solely on 22 selected sectors, which have been identified in Annex 5 as being very dependent on public procurement - potentially 'captive industries' under individual general government expenditure categories (using the COFOG classification of government activities):

- Defence
- Aerospace
- Postal machinery & airport sorting systems
- Fire-fighting and sea rescue equipment and transport
- Infrastructure construction and dredging
- Construction materials
- Railway equipment
- Urban buses
- Power generation
- Water management and sewage
- Waste management and other environmental services
- Pharmaceuticals
- Medical equipment
- Specialised textiles
- Business services (consulting, auditing/accounting, advertising, legal services)
- Financial services
- Oil, mining and gas exploration equipment
- Fixed telecom equipment
- Computer & IT equipment and software
- Street lighting
- Port equipment
- Broadcasting equipment

The selection was probably undertaken by expert judgement: there is no indication in the text that some data or other supporting evidence was used. However, **the selection is seen as being reasonable**. Whilst important sectors such as food and beverages or furniture are not included, it may be argued that the opening up of global public procurement markets would have limited impact on them as most of their revenues do not come from the public sector and the importance of global - as compared to local - markets is less pronounced.

The 22 sectors are also categorised according to the level of skills required and 'revealed quality elasticity' (RQE). This latter classification is based on the relative apparent role of

quality and price in the competitive position of goods and services exported. A product is considered to have a high RQE if changes in the unit value of its exports over an earlier year are generally coupled in most bilateral trade relations of the EU with changes in the same direction in the net amount exported (i.e. volume of export minus volume of imports).[25] In such a case, empirical data would 'reveal' that price is not the decisive factor of the competitiveness of that specific product. Conversely, the product would have a low RQE if, for instance, an increase in unit value would generally yield a decrease in net export volumes in the most important bilateral trade relations of the EU. The source for the classification of sectors is not shown in the text but it could be Aiginger (2000)[26] or Janger et al. (2011)[27]. It should be noted that there are no natural thresholds separating high-, medium- and low-skill or RQE sectors and thus the distance between a medium and high-RQE sector may be smaller than between two high-RQE sectors.

For the selected 22 sectors, separately for 12 key partner countries[28] plus the EU, a degree of dependency from public procurement was assessed on a five-point scale[29]. This again is to a large extent based on expert judgement: the researchers were interrogating national legislation or websites of national authorities or contracting authorities to identify whether the main purchasers are private or public entities and whether calls for tender are conducted.

The assessment of the degree of *de jure* and *de facto* market openness for the above 22 sectors was done - for the 12 key partners - through a rather elaborate review of the (GPA or other) commitments of the third countries concerned towards the EU, including specific derogations. The sectors were classified into 3 categories of market openness: "not committed" (score of -1); "partly committed", i.e. some international restrictions being present (0) and "fully committed" (1), presented in a table. **This approach allows only for a very broad classification**, blurring considerable differences. However, the complexity of rules and derogations, as well as the difficulties when trying to weigh the significance of these against each other justifies the limited granularity of this assessment.

This **assessment for the EU (e.g. in the form of an additional table showing the commitments of the EU towards its key trading partners) is however missing** from the Impact Assessment, there is consequently **no comparison of the degree of market**

[25] These calculations are done using data from Eurostat's external trade (COMEXT) database.

[26] Aiginger (2000) *Europe's position in quality competition*. Background Report for the European Competitiveness Report, European Commission, DG Enterprise. Available at: " http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=1854

[27] Janger et al. (2011) Structural Change and the Competitiveness of EU Member States. Available at: http://ec.europa.eu/enterprise/policies/industrial-competitiveness/documents/files/structural_change_en.pdf

[28] United States, Japan, Canada, Korea, Israel, Mexico, China, Russia, India, Brazil, Turkey, Australia.

[29] 0 – no dependency; 0.5 – almost no dependency; 1 – partial dependency; 1.5 – high dependency; 2 – full dependency.

openness in the EU and its trading partners. The document merely explains that around 85% of the EU's public procurement market (this concerns above-threshold procurement only) is committed under the GPA to other signatories - to increase to ca. 95% further to the recent conclusion of GPA negotiations. Defence procurement, Annex II B services and fuel purchases by utilities are excluded ("uncovered"), and concessions, railway operators and gas entities are implicitly uncovered by the agreement. It would be easy to present this information in relation to the 22 sectors in a table covering GPA signatories. However, the EU has also negotiated a series of specific derogations[30] vis-à-vis certain third countries (examples given in the document concern access to public works and services of local contracting authorities for US operators; or access to urban transport tenders for Japanese operators), which would complicate the table.

As for non-GPA relations, **it is not explained in the Impact Assessment what kind of restrictions apply in respect to countries with which the EU has concluded a free trade agreement (FTA) or a Stabilisation and Association Agreement (SAA)**. Such agreements are generally vaguely phrased; for instance, The Economic Partnership, Political Coordination and Cooperation Agreement with Mexico[31] e.g. talks in Article 10 on public procurement merely about a "gradual and mutual opening of agreed government procurement markets on reciprocal basis", whilst the covered products, thresholds, procedural arrangements and timetables are determined by a Joint (EU-Mexico) Council decision. To set up the table on the openness of the EU public procurement market towards Europe's main trading partners, all corresponding decisions in force (covered products, thresholds, possible exemptions) ought to be reviewed and processed. According to available information and a sample of countries, these agreements do however set up the same delineations as the EU's GPA commitments.

For gauging the *de facto* openness of the EU's public procurement market, **there are no clearly restrictive regulations** apart from the price preference mechanism of Article 58 of the 'Utilities' Directive 2004/17/EC (although this stipulation is not taken forward in the Commission's recent proposal for a new directive). It should however be noted that **there is a wealth of possible hidden market entry barriers that are not regulated by international agreements but are often used by contracting authorities** – e.g. requiring past working experience in the country concerned ("similar services rendered"), asking for country-specific certifications, publishing tender documents in national language only, not accepting documents issued in a different language without official translation, short deadlines (especially restricted procedures), etc. These are not quantifiable but can have a major impact on the opportunities of foreign bidders wishing to enter the market.

The **figures on the volume of "contestable" public procurement markets are equally rather broad estimates**. As rightly pointed out in the Impact Assessment, detailed data on public procurement activities of third countries is unfortunately very difficult to

[30] Available at: www.wto.org/english/tratop_e/gproc_e/eugene.doc

[31] Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:276:0045:0061:EN:PDF

procure. Table 3 on page 11 gives estimates on the total size (in billion euros) of public procurement markets committed under the GPA (above thresholds and covered by the agreement), i.e. *de jure* open, contestable markets. The calculations were made by DG MARKT and are based on WTO estimates (for non-GPA countries) and partly probably on GPA statistical data provision according to Article XIX:5 for GPA signatories.

It should be pointed out that the relevant market size, i.e. above-threshold public procurement, is only a fraction of the total public procurement volume. In its most recent publication on public procurement indicators[32], the European Commission, DG MARKT estimates that the total expenditure by general government and utilities in the Member States (i.e. excluding the European institutions) on works, goods and services at 2,406 billion in 2011, of which only €425 billion (17.7% of total expenditure, corresponding to 3.4% of the EU's combined GDP) was published in the EU's Official Journal.

Q1.2 Has the factual vs. legal openness of the EU public procurement market been assessed?

There is a rather elaborate analysis of the *de facto* openness of third country public procurement markets (22 key sectors in 13 countries) in Annex 8, feeding into the treatise in Annex 3. The latter concludes that almost 75% of the above-threshold (GPA) procurement markets in the countries analysed are either de facto closed (via national or local price preference mechanisms[33], discriminatory set asides, national or local establishment or content requirements) or can be potentially closed if existing restrictive measures were applied systematically (this mostly concerns 'uncovered' goods and services but certain measures even close markets which are *de jure* committed). **Of course this estimate is again largely based on expert judgement** on the strength and significance of discriminatory national measures and on the extent to which they are systematically applied in the country concerned.

A similar systematic review of the de facto openness of the European public procurement market has not been undertaken. There is only limited discussion of factual openness, with the Impact Assessment simply stating that the EU market is factually completely open, which reduced the EU's room of manoeuvre in negotiations. This is said to be confirmed by high-profile contracts awarded to third-country operators in "uncovered" areas, and especially areas where reciprocity is not granted. **There are indeed no discriminatory rules in the EU such as the ones identified for third countries** in Annex 8 (leaving aside Article 58 of the Utilities Directive No. 2004/17/EC), but access to the market can nevertheless be difficult in practice. A range of "soft" practical measures such as requesting relevant domestic track record, setting up of a local project

[32] http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/public-procurement-indicators-2011_en.pdf

[33] National preference regimes are in place e.g. in Russia, Brazil or Turkey and local regimes in the United States, Australia, Canada and India.

office, employing local staff, asking for specific European standards or certifications can be seen as barriers to the entry of foreign participants.

Q1.3 Is the information on openness of public procurement markets provided in the Commission's impact assessment consistent? What about, notably, "uncovered" goods and services?

The Impact Assessment states that EU public procurement markets are factually open also for "uncovered" goods and services (they are of course legally not open). One third of contracts awarded to non-EU companies (including their subsidiaries) concerns non-covered procurement, e.g. in rolling stock for railways or metro, or construction of motorways.

The factual openness of uncovered markets in third countries has not been analysed. This would have required an elaborate review of national legislation and its application separately for each sector (as in Annex 8 for the 22 key "covered" sectors) which would have been a disproportionate task.

Q1.4 To underpin the situation - could data be provided on openness of public procurement in 5 European capitals and 5 global cities (case study)?

The idea for looking at cities may come from the Impact Assessment mentioning the example of urban transit systems, with information sourced from the subscription-based Infra-deals database (http://www.infra-deals.com). The document explains that most urban transport projects were not open under any international commitment. After studying available data (see answer to Q0), case studies on the openness of procurement in selected cities (within the limitations of this assignment) **do not seem to be possible**. It was possible however to **interrogate contract award notices published on TED** and conduct an elaborate analysis of contracts awarded to a third country in terms of Member State awarding the contract, country of the economic operator winning these contracts, the CPV code of the purchase, the type of awarding authority, type of procedure etc. This paper gives furthermore a **brief overview of relevant Japanese procurement statistics** published within the framework of the WTO GPA.

The analysis of contract award notices published in the EU's Official Journal (on the TED portal) in 2011 shows that **only 964 out of 469,443 contracts (0.2% of all contracts; and 2.2% of all cross-border contracts) above the EU-threshold were awarded directly to economic operators located in third countries** (see Figures 1 and 2). This figure includes 14 contracts awarded by French authorities to companies located in Monaco and 11 Italian contracts going to companies located in San Marino which should of course not be considered third countries for the purpose of the new legislation - and maybe around one hundred contracts going to local suppliers within the context of Member State authorities' overseas operations (development aid projects, maintenance of military bases etc., most of which were tendered by UK authorities), which are also not in the focus of

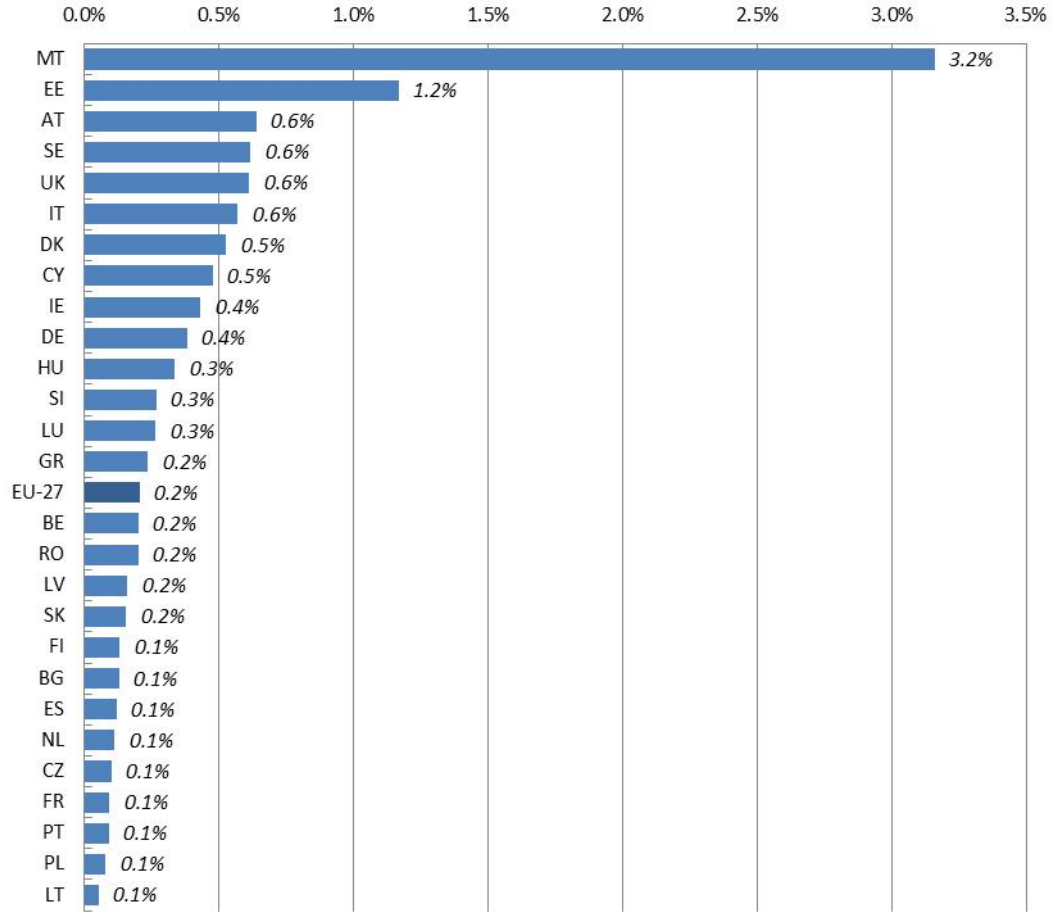
the legislation. Of the largest Member States, contracts were less likely to be awarded to third-country operators in France, Spain and Poland; whilst the rate was considerable above the EU average in the UK, Italy and Germany. **The number of public contracts with at least 50% of the value being spent on goods or services sourced from third countries is of course much higher than 964** – it is assumed that the majority of such sales is done through local affiliates or dealers, in a consortium led by an EU company or through being subcontractor to a general contractor from the EU.

Figure 8 – Contracts above EU-thresholds won by third-country economic operators (2011)

Member State	Total number of contracts	Domestic pro-curement	Cross-border pro-curement	of which: third country operator	Third country operator/ total	Third country/ cross-border
AT	3,291	2,907	384	21	0.6%	5.5%
BE	6,010	5,148	862	12	0.2%	1.4%
BG	6,995	6,888	107	9	0.1%	8.4%
CY	1,051	970	81	5	0.5%	6.2%
CZ	6,045	5,794	251	6	0.1%	2.4%
DE	30,397	27,659	2,738	116	0.4%	4.2%
DK	5,124	4,235	889	27	0.5%	3.0%
EE	1,627	1,513	114	19	1.2%	16.7%
ES	22,062	12,964	9,098	26	0.1%	0.3%
FI	6,852	4,370	2,482	9	0.1%	0.4%
FR	135,057	124,010	11,047	124	0.1%	1.1%
GR	3,386	3,115	271	8	0.2%	3.0%
HU	6,277	5,830	447	21	0.3%	4.7%
IE	3,945	3,557	388	17	0.4%	4.4%
IT	19,830	15,178	4,652	113	0.6%	2.4%
LT	9,790	9,654	136	5	0.1%	3.7%
LU	379	303	76	1	0.3%	1.3%
LV	11,339	10,498	841	18	0.2%	2.1%
MT	190	152	38	6	3.2%	15.8%
NL	6,236	5,875	361	7	0.1%	1.9%
PL	114,937	111,351	3,586	91	0.1%	2.5%
PT	2,235	1,673	562	2	0.1%	0.4%
RO	18,065	17,747	318	36	0.2%	11.3%
SE	7,786	7,469	317	48	0.6%	15.1%
SI	6,384	6,109	275	17	0.3%	6.2%
SK	1,929	1,770	159	3	0.2%	1.9%
UK	32,224	28,800	3,424	197	0.6%	5.8%
EU-27	**469,443**	**425,539**	**43,904**	**964**	**0.2%**	**2.2%**

Source: Own calculations based on contract award notices published on TED in 2011.

Figure 9 – Proportion of contracts above the EU-thresholds awarded to economic operators from third countries (2011)



Source: Own calculations based on contract award notices published on TED in 2011.

The aggregate value of contracts directly awarded to companies from third countries, for which information is available (538 contracts out of 964), was €1.5 billion (0.5% of all procurement above EU-thresholds). **This may be grossed up to an overall estimate of some €2.8 billion** assuming that the size of contracts with missing value data are similar to those with available figures. **In reality the overall amounts paid out to third-country contractors under these contracts will be significantly lower as some of them are multiple framework contracts where third-country operators are only one out of several suppliers contracted**. On the other hand, the volume of goods and services indirectly procured from third country operators via local affiliates, dealers, or via consortium or subcontracting arrangements where the lead contractor is from the EU is much higher.

The share of procurement going to third-country companies ranged from less than 0.1% in Portugal, Slovakia, the Netherlands and the Czech Republic to above 2% in Cyprus, Malta, Bulgaria, Finland and Ireland (see Figures 3 and 4). Note however that a few high-

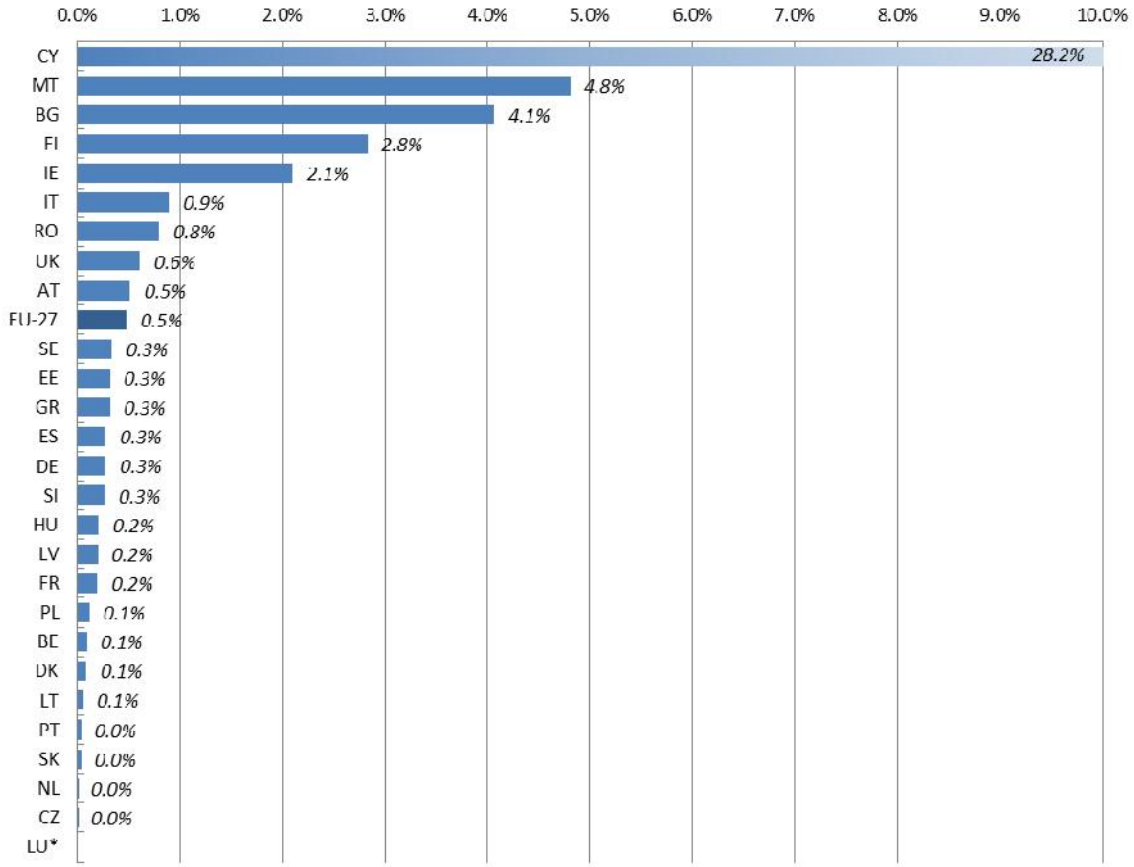
value contracts ('outliers') had a very significant impact on this indicator, and the country figures would be possibly evened out to a certain extent if data from other years were added.

Figure 10 – Aggregate value of contracts above EU-thresholds won by third-country economic operators (only contracts where value is known), million euros (2011)

Member State	Aggregate value of contracts	Domestic pro-curement	Cross-border pro-curement	of which: third country operator	Third country operator/ total	Third country/ cross-border
AT	2,452.7	2,279.7	172.9	12.6	0.5%	7.3%
BE	4,974.0	4,542.0	431.9	4.6	0.1%	1.1%
BG	2,024.4	1,772.9	251.6	82.4	4.1%	32.8%
CY	801.6	486.7	314.9	226.0	28.2%	71.8%
CZ	14,875.9	13,734.4	1,141.5	0.4	0.0%	0.0%
DE	14,393.3	13,838.2	555.0	40.0	0.3%	7.2%
DK	3,340.2	3,086.0	254.2	2.9	0.1%	1.1%
EE	1,970.2	1,725.8	244.3	6.3	0.3%	2.6%
ES	24,869.1	19,606.4	5,262.7	69.7	0.3%	1.3%
FI	2,370.7	2,085.3	285.4	67.0	2.8%	23.5%
FR	51,794.6	50,778.6	1,016.0	100.0	0.2%	9.8%
GR	2,367.0	2,285.2	81.7	7.5	0.3%	9.2%
HU	8,551.9	8,314.2	237.7	17.8	0.2%	7.5%
IE	272.0	255.0	17.0	5.7	2.1%	33.6%
IT	34,456.3	30,433.4	4,023.0	307.6	0.9%	7.6%
LT	1,601.9	1,414.5	187.5	0.9	0.1%	0.5%
LU*	1,692.2	295.5	1,396.7	:	:	:
LV	6,926.8	6,857.3	69.5	13.8	0.2%	19.9%
MT	182.1	141.1	41.0	8.8	4.8%	21.3%
NL	7,118.6	6,904.7	213.9	0.2	0.0%	0.1%
PL	44,230.9	37,876.0	6,354.9	53.5	0.1%	0.8%
PT	2,503.0	2,065.8	437.3	0.9	0.0%	0.2%
RO	10,800.1	8,711.1	2,089.0	86.4	0.8%	4.1%
SE	1,146.7	1,124.9	21.8	3.9	0.3%	17.8%
SI	859.7	803.1	56.6	2.3	0.3%	4.0%
SK	1,908.9	1,817.2	91.7	0.6	0.0%	0.7%
UK	68,278.4	67,090.3	1,188.2	417.6	0.6%	35.1%
EU-27	**316,763.2**	**290,325.3**	**26,437.9**	**1,539.5**	**0.5%**	**5.8%**

** No contracts awarded to third-country operators with a known contract value for Luxembourg*
Source: Own calculations based on contract award notices published on TED in 2011.

Figure 11 – Share of contracts above the EU-thresholds awarded to economic operators



from third countries, in terms of value (only contracts where value is known) (2011)

** No contracts awarded to third-country operators with a known contract value for Luxembourg*
Source: Own calculations based on contract award notices published on TED in 2011.

From among the EU's main trading partners, companies **from Switzerland and the United States were the most successful** in securing public contracts above the EU-thresholds - together accounting for 53% of all contracts awarded to third-country operators - followed by Norwegian and Canadian enterprises (see Figure 5). These contracts include a high number of relatively low value purchases of medical equipment and pharmaceuticals from (predominantly Swiss) specialised suppliers, but also high-value procurement of, for instance, rolling stock, fuels, or academic journals (EBSCO from the US).

'Other' countries in the table include Nigeria with 60 contracts (of which 58 are supplies under a multiple framework agreement concerning medical equipment and/or pharmaceuticals for an African operation of the UK Government's Department for International Development - DFID), as well as Monaco and San Marino with 14 and 11 contracts, respectively.

Figure 12 – Number of contracts above EU-thresholds won by economic operators from selected third countries (2011)

Trading partner	Works	Supply	Service	TOTAL
Switzerland	9	230	42	**281**
United States	1	149	83	**233**
Norway	2	42	25	**69**
Canada	1	37	24	**62**
China (incl. Hong Kong)		21	9	**30**
Croatia		15	11	**26**
India		10	12	**22**
Russia		8	13	**21**
Japan		13	5	**18**
Israel	1	10	5	**16**
Turkey	2	10	2	**14**
Korea		8	1	**9**
Australia	1	4	3	**8**
South Africa		2	2	**4**
Brazil		3		**3**
Others	4	106	38	**148**
Total	**21**	**668**	**275**	**964**

Source: Own calculations based on contract award notices published on TED in 2011.

In terms of value, the league table of third countries is led by Switzerland by a wide margin; the United States and Turkey follow (see Figure 6).[34] Around 60% of the contract volume has been won by companies located in EFTA and candidate countries, Monaco or San Marino. Intriguingly, the table reveals that some of the key trading partners of the EU (China, India) play only a miniscule role in public procurement through direct contracting – although, evidently, much higher volumes of goods and services from these countries can access European public procurement markets through local affiliates or dealers (these goods or services could still be subject to restrictions).

[34] Factually, Liechtenstein comes second on the list due to the inclusion of a company registered there (Jetion Solar) in a large UK multiple framework contract concerning the supply of micro (solar) power generation technologies worth €251 million. The company is however only one of many companies shortlisted and its share of the contract value is likely to be correspondingly low.

Figure 13 – Aggregate value of contracts above EU-thresholds won by economic operators from selected third countries (only contracts where value is known), million euros (2011)

Trading partner	Works	Supply	Service	TOTAL
Switzerland	7.5	441.3	23.8	**472.5**
United States	2.8	81.6	61.2	**145.6**
Turkey	12.7	108.1	0.1	**120.9**
Russia	-	84.3	2.1	**86.4**
Canada	27.6	12.6	46.0	**86.2**
Japan	-	59.6	2.2	**61.8**
Korea	-	59.1	-	**59.1**
Brazil	-	58.8	-	**58.8**
Croatia	-	22.3	35.8	**58.1**
Israel	12.5	15.5	5.1	**33.0**
China (incl. Hong Kong)	-	19.4	2.6	**22.0**
Norway	-	12.4	8.4	**20.8**
Australia	-	3.9	8.0	**12.0**
India	-	3.5	0.2	**3.7**
South Africa	-	0.2	-	**0.2**
Others	12.7	278.2	7.6	**298.4**
Total	**75.8**	**1,260.7**	**203.0**	**1,539.5**

Source: Own calculations based on contract award notices published on TED in 2011.

Further analysis of the data shows that **the supply of transport equipment, construction material, printed matter, as well as the provision of construction work and architectural, construction and engineering services** are the sectors with the largest sums involved in procurement going to operators from 'covered' third country operators – i.e. excluding contracts won by EFTA and candidate countries as well as companies from Monaco, San Marino (see Figure 7).

Figure 14 – Top 10 CPV categories by the aggregate value of contracts above EU-thresholds won by economic operators from 'covered' third countries (only contracts where value is known), million euros (2011)

CPV	CPV name	Combined value	Share of total
34	Transport equipment and auxiliary products to transportation	156.0	26.0%
44	Construction structures and materials; auxiliary products to construction (excepts electric apparatus)	132.2	22.0%
45	Construction work	49.1	8.2%
22	Printed matter and related products	48.4	8.1%
71	Architectural, construction, engineering and inspection services	46.1	7.7%
72	IT services: consulting, software development, Internet and support	25.9	4.3%

31	Electrical machinery, apparatus, equipment and consumables; Lighting	25.4	4.2%
38	Laboratory, optical and precision equipment (excl. glasses)	19.9	3.3%
79	Business services: law, marketing, consulting, recruitment, printing and security	19.0	3.2%
73	Research and development services and related consultancy services	11.2	1.9%
	Other	67.6	11.3%
	Total	600.7	**100.0%**

Source: Own calculations based on contract award notices published on TED in 2011.

Potential benefits of market opening

Q2.1 What about the potential benefits of new markets, has the value of these markets in EURO been consistently and correctly assessed? (p.m.)*[35]

Q2.2 Are there any more precise figures in terms of turnover of contracts won by EU companies in third countries?

No comprehensive dataset could be identified. Generally, obtaining comparable international data on public procurement is a difficult task. Data provided by third countries through WTO within the GPA framework is sparse and does not include information on the number and value of contract won by EU companies, **with the exception of Japan**.

Still, there are data sources – if not for all countries of interest – that could be used, although that would need significant additional time and effort. A **useful fee-based international database** containing information on large infrastructure projects, Infra Deals (http://www.infra-deals.com) has already been mentioned in the Impact Assessment.

There are also **a few accessible national databases** (such as the TED in the EU) in some third countries from which information may be requested or which could be interrogated by a person with the right language skills to compile statistics on the number and value of contracts won by European companies, for instance http://www.usaspending.gov/ in the United States.

[35] This topic, addressed in other expert papers, is here *pour mémoire* for congruence with the structure of the questions requested by INTA.

Impact on job creation of the different options

Q3.1 What about the consistency and assumption of methodology used for evaluating the impact on job creation and working conditions within the public procurement internal market and impact on EU environmental and social standards of the different options?

The impact of the policy options on job creation is **directly derived from the expected impact on export volumes**; in specific:

- from additional expected export due to market opening; and
- from losses in existing exports expected due to retaliatory actions.

As indicated in the main text and briefly explained in Annex 7 (page 17), **a fixed ratio between export and corresponding job creation was assumed**: 15 additional jobs for every €1 million of additional exports. This ratio is said to be calculated on the basis of the symmetric input-output tables for the EU-27 and individual Member States[36]. It is mentioned in Annex 7 that for this calculation the current export volumes have been divided by the total number of jobs in the sectors concerned[37]. However, the method - as it was not explained in the document in more detail - is **not clear, and it could not be replicated** by looking at the relevant data sources. According to the input-output table for the EU-27, total exports in 2007 accounted for €1,627 billion, whereas the Impact Assessment talks about €1,382 billion. The level of domestic production of goods and services was €11,011. In the same year, there were 220,435,100 persons employed in the EU as per Eurostat data.[38] If we assume – as was probably done in the study – that the share of all jobs in the economy generated by export (i.e. not only the 22 key sectors!) equals the share of exports in total domestic production, the result would be 32.6 million jobs involved directly or indirectly in generating exports, whilst the Impact Assessment calculated 21.4 million jobs.

Another possibility is that the share of export to overall domestic production was only applied to employment figures for the 22 key sectors, individually. In this case, a correspondence table between the 22 key sectors and the sectors used in the input-output tables as well as in the Eurostat employment tables would be helpful. In this case, however, the knock-on job creation in the industries supplying these sectors would have had to be taken additionally into account, via the input-output tables.

[36] Available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/esa95_supply_use_input_tables/data/workbooks

[37] The number of jobs by sector can be sourced from Eurostat.

[38] Employment (main characteristics and rates) - annual averages [lfsi_emp_a]

Although sufficient information to review and analyse the exact method used is not available in the document, **it can be presumed that it carries the possibility for certain biases**:

6. The method probably leads to an **overestimation of the potential of additional EU exports to create/safeguard European jobs.** The Impact Assessment itself mentions that the method does not take into account efficiency gains and spare capacity; but there are at least three other reasons why the fixed ratio applied may be a significant overestimation:
   - most of the 22 sectors identified in the Impact Assessment as being dependent upon public procurement are highly capital-intensive, i.e. their direct employment generation potential is lower than that of other sectors which were included in the calculations;
   - European access to third country public procurement markets will probably dominated by relatively large contracts (they will be above GPA-thresholds), thus by large enterprises which generally have less labour-intensive production processes than smaller enterprises who are also included in export statistics;
   - projects undertaken in third country public procurement markets would by all probability have a higher local or at least non-EU content - including local staff - than general exports (note that products such as foodstuff are also included in the statistical method, which are usually not dependent on the existence of local staff), considering that authorities are likely to formulate such requirements or that bidders are likely to improve their chances of winning the contract – as well as ensuring effective delivery – by teaming up with local providers.

7. Evidently, **the method cannot take account of the fact that the positive impacts of the policy options in terms of additional exports will occur in different sectors and different Member States** – all with very different employment-generation potential. The document did not analyse in more detail which export markets are likely to be opened up (to a larger extent) to European economic operators, mainly due to uncertainties about what the EU, even with its increased leverage, could achieve in trade negotiations.

8. **All export and associated employment impacts were calculated only in relation to the 12 key trading partners of the EU**. Evidently, the policy options will also impact on other bilateral trade relationships. A review of trade statistics (i.e. all international trade, not only public procurement-related trade) shows that the 12 partner countries selected only account for about half of the EU's exports and imports (see Figure 8). EFTA members, candidate countries and ACP partners - many of which are in the "Least Developed Country" category - against which public procurement restrictions will most probably not introduced, account roughly for an additional 25%. Therefore we may assume that the calculated impacts of the policy options on additional export volumes and the corresponding job creation effects can be increased by about 50%.

9. Most importantly, the **employment impacts stemming from a reduction in imports and the wider supply chain impacts seem to be missing from the assessment** (see more detail below).

10. **Some of the minor working assumptions used for the calculations may also be challenged**; for instance, under Option 2A, the assumed 50% usage of Article 58 of the Utilities Directive to reject offers from third countries seems to be too high, considering the current unwillingness of contracting authorities and entities to use this option – and that the proposal for a revised Directive does not retain this Article. The assumed rate of rejection under option 3B of 25% may also be too high – the Impact Assessment itself is referring in the problem description to the unwillingness of authorities to reject attractive offers from third countries (this is also linked to a perceived legal uncertainty).

Figure 15 – International trade in goods and services of the EU27, by selected partner countries, 2011 (million euro)

Trading partner	International trade in goods		International trade in services (BoP statistics)		Total	
	Export	Import	Export	Import	Export	Import
United States	263,791	191,515	145,548	140,159	409,339	331,674
Japan	49,018	69,229	21,802	15,909	70,820	85,138
Canada	29,885	30,406	15,937	10,093	45,822	40,499
Korea	32,510	36,175	9,021	4,522	41,531	40,697
Mexico	23,909	16,815	5,820	3,181	29,729	19,996
Israel	16,885	12,739	4,740	3,353	21,625	16,093
China	136,372	293,692	26,245	18,314	162,617	312,006
Russia	108,355	199,922	24,085	14,253	132,440	214,175
India	40,558	39,683	11,426	10,843	51,984	50,525
Brazil	35,752	38,940	11,466	7,139	47,219	46,078
Turkey	73,096	48,143	9,429	14,787	82,525	62,930
Australia	31,159	14,944	15,905	7,342	47,064	22,286
12 key partners total	**841,290**	**992,201**	**301,424**	**249,896**	**1,142,714**	**1,242,097**
EFTA partners	189,278	190,977	102,222	67,285	291,500	258,262
Candidate countries	89,927	59,021	12,598	22,221	102,525	81,242
ACP partners	81,811	89,522	36,165	23,516	117,976	113,038
Other extra-EU27 trade	357,033	392,486	151,532	119,984	508,565	512,470
Extra-EU27 total	1,559,339	1,724,207	603,941	482,902	2,163,280	2,207,109
Intra-EU27 total	2,805,931	2,739,965	759,429	696,376	3,565,360	3,436,341
Total	**4,365,270**	**4,464,172**	**1,363,372**	**1,179,277**	**5,728,642**	**5,643,450**

Source: Eurostat, International trade in services (since 2004) [bop_its_det]; EU27 trade by SITC product group since 1999 [ext_st_eu27sitc]

Q3.2 Is it consistent that for very different scenarios the same figure of jobs created has been calculated?

The Impact Assessment calculates with an additional export volume of €2 billion for policy option 2A, and with €4 billion for policy options 3A, 3B, 3C and 4, assuming that the EU will be able to obtain open access to all markets at the 12 key trading partners where these trading partners have offensive trade interests (and are therefore very interested in gaining access to the corresponding European markets). The additional export volumes, as explained in the document, are expected to be a result of the increased leverage of the EU to negotiate more favourable trading terms with these third countries.

Whilst it would seem odd that the same figure has been used for four different policy options, **this is not an unreasonable assumption**. It is not possible to foretell the outcomes of the negotiations, and the 'realistic' estimate of €4 billion in additional exports can be contested, but relatively small differences in the policy options will probably not have a significant impact on the EU's leverage/negotiation power or on the trading partners' offensive interests, hence on the expected additional export volumes.

It should be also noted that the assessment **does make a distinction between the policy options in terms of level of rejected imports and related supply chain effects; as well as the expected level of retaliation from third countries**. These effects modify the ultimate expected impacts significantly.

Q3.3 Has the impact on jobs from both exports and stemming from procurement of domestic goods and services been evaluated?

One crucial gap in the calculations is omitting the impact on job generation from replacing imports with domestic production in cases where offers from third-country economic operators will be rejected. The policy options for which the impacts were quantified (i.e., 2A, 3A, 3B, 3C and 4) assume that, if implemented, a certain amount of third-country imports will be rejected by contracting authorities and entities. Estimates were made in the Impact Assessment on what the volume of this would be, and also on the volume of European export built into this import volume (supply chain impact) that would not materialise in case of a rejection. One part of the rejected imports will be replaced by imports from other countries, e.g. GPA-signatories against whom no restrictions are applied. However, the remaining part of rejected imports will be produced within the EU, thus clearly having an employment impact, which has not been estimated in the Impact Assessment.

Figure 9 overleaf makes an attempt to dimension the job creation impact of import rejection, together with the supply chain effects coming from European content of rejected bids not materialising. A very crude assumption of 50% was made to estimate the proportion of rejected import replaced by European production. It should be noted

though that the volume of rejected bids may have been overestimated by the Impact Assessment, as explained in the section above (point 5 in the list). Notably, the assumed 50% usage of Article 58 of the Utilities Directive or the assumed rate of rejection under option 3B of 25% could to be too high, considering the unwillingness of authorities to reject attractive offers from third countries.

The table also summarises the expected impacts from additional export and retaliation, already calculated in the Impact Assessment.

Figure 16 – Estimated impact of the policy options on additional EU export and corresponding job creation

Policy option	Import rejection / wider supply chain effects		Retaliation (normal scenario)		Additional export		Total job creation impact**
	Value	Job creation impact*	Value	Job creation impact	Value	Job creation impact	
2A	€1 bn	*7,500*	-€0.4 bn	-6,000	€2 bn	30,000	31,500
3A	€4.1 bn / -€0.6-0.8 bn	*24,800-26,300*	-€1.1 bn	-16,500	€4 bn	60,000	68,300-69,800
3B	€1 bn / -€0.1-0.2 bn	*6,000-6,800*	-€0.3 bn	-4,500	€4 bn	60,000	59,500-60,300
3C	€3.1 bn / -€0.4-0.6	*18,800-20,300*	-€0.8 bn	-12,400	€4 bn	60,000	66,400-67,900
4	€2 bn / -€0.3-0.4	*12,000-12,800*	-€1 bn	-15,000	€4 bn	60,000	57,000-57,800
5	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*
6	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*	*no analysis*

**A ballpark estimate assuming that 50% of the imports rejected will be replaced by imports coming from other third countries (e.g. GPA signatories) with similar supply chain effects and that the employment generation ratio of import avoided - i.e. domestic production - equals that of additional exports.*
*** Total of the three estimations; carries some overestimation as explained above.*

Q3.4 What is the impact of the proposal (notably Articles 6, 10 and 7) with regard to working conditions and respect of environmental and social criteria set at EU and national level?

Article 6 of the Commission's proposal sets out the right of contracting authorities and entities – subject to approval from the Commission - to reject under certain conditions bids concerning non-covered goods services from third-country bidders. It furthermore

establishes the procedure for the exclusion and the terms under which the Commission would give its approval.

Article 10 empowers the Commission to adopt implementing acts that would temporarily limit the access of non-covered goods and services originating from a third country to European public procurement if restrictive procurement measures of third countries lead to a lack of substantial reciprocity in market opening (exclusion of tenders or a mandatory price penalty).

Article 7 requires contracting authorities and entities in case they wish to accept abnormally low tenders concerning non-covered goods or services and originating outside the EU to inform all tenderers about their intention and the reasons for it.

The Impact Assessment **says very little in relation to the expected impacts of the options on working conditions, environmental and social standards** on the internal market. It is known that very substantial differences exist between social and environmental regulations in force in the EU and most third countries. Whilst European regulations are relatively strict (even if economic operators do not always abide by the rules in practice, as witnessed by national labour inspectorates), rules and their enforcement are currently much laxer in the majority of emerging markets and developing countries.

The document **briefly discusses, in a qualitative manner, that barriers to third country goods and services may undermine the incentive of foreign firms to adopt stricter environmental and social standards** – although the impact is considered to be merely marginal. As the only concrete example, it is outlined in the document that the enhanced application of Article 58 of the Utilities Directive (which is however not retained in the current reform proposal of the Commission!) could negatively impact the worldwide diffusion of EU standards in utilities' sectors (Buses in Clean Vehicles Directive). Examples for knock-on effects on social standards and working conditions (child labour, forced labour) are only shortly mentioned in the assessment, even though the results of the stakeholder consultation (Annex 2) elaborate on these topics. It is of course important **to note that these impacts are occurring *elsewhere*, i.e. not on the EU's internal market**.

As concerning impacts occurring in the EU, reduced imports (more domestic EU production) are very likely to lead to shorter transport distances, hence **a slightly lower burden on the environment**. Conversely, it may be added that an increase in EU exports to third countries (as it generates economic activity in the EU as well as long-haul transports) may lead to an additional environmental burden. Increased export volumes of successful export-oriented industries (mostly quality-intensive industries with highly skilled labour and higher wages) through better market access, and rejecting foreign companies who may aggressively undercut domestic rivals by not offering the same working conditions **can only improve the overall situation in terms of working conditions in the EU**.

The Impact Assessment could however not quantify these impacts. Firstly, the evolution of standards and their enforcement depend on many complex factors: national legislation may change, and most economic operators will probably continue making efforts to comply with higher environmental (and even social) standards for products intended for developed markets, as this would be necessary to successfully compete on these markets. Secondly, it may also be argued that the expected impacts of the options on trade volumes are relatively small in the first place, when compared to the volume of total imports or the size of the European public procurement market. **Knock-on effects on environmental and social standards are therefore likely to be so marginally small that an Impact Assessment will indeed not be able to quantify them**.

Risk of retaliation and leverage creation (p.m.)[39]

Q4.1 Is there evidence of the Commission's assumption that the more an option limits access to foreign goods and services the higher the risk of retaliation is? (p.m.)

Q4.2 Is the Commission's estimate of the risk of retaliation consistent and based on evidence and a proper methodology? (p.m.)

Q4.3 Has the potential of leverage for market opening in third countries being properly assessed? (p.m.)

Q4.4 Taking into account game-theory - what assumptions can be made about the risk of retaliation for each of the proposed options and possibilities to create leverage for negotiations through this instrument? (p.m.)

Administrative burden of assessed options

Q5.1 Is the estimation of the number of notification cases correct?

The method for estimating the number of expected notification cases per policy option is not well described in the Impact Assessment (note that different types of notifications are concerned). Usually only the end results of the calculations are given under the assessment of impacts for the individual policy options (Annex 4), but not the underlying assumptions and the method for the calculations.

[39] This topic, addressed in other expert papers, is here *pour mémoire* for congruence with the structure of the questions from INTA.

For instance, under option 3A, the impact assessment document explains that if contracting authorities had to send a full notification to the European Commission to issue waivers e.g. for computers, fuel, medical equipment and pharmaceuticals, the total administrative burden would amount to €1,989,000. The number of expected notification cases however, and the calculation method is not presented in the text. Similarly, it is not explained what type of costs this estimation refers to. In 2011, the total number of tenders above the EU thresholds published on TED was 168,160.[40] The Impact Assessment explains that the sectors mostly impacted by the proposed legislation - computers, fuel, medical equipment and pharmaceuticals – represent 15% of this amount, thus 25,224 tenders. Evidently, the number of notification cases will be much lower than that in practice, but the calculation method could not be identified in the text.

For option 3B, the document calculates with 554 notifications by dividing the expected volume of purchases concerned (€1.1 billion) by the average value of public contracts (which is hence around €2 million). **It is not clear at this stage how the expected volume was calculated**. This should be some proportion of the 25,224 tenders per year in the sectors concerned but the method is not described in the impact assessment. **Neither is it clarified what the 'average contract value' relates to**: all public contracts above the EU-thresholds or GPA thresholds; above-threshold contracts in the sectors concerned; contracts for 'covered' goods etc. The number of notification cases is paired with a cost estimate of €97,859 affecting contracting authorities (4 hours of work, an average cost of €44 per hour).

For option 3C, the Impact Assessment calculates with 1,952 notifications for foreign computers, fuel, medical equipment and pharmaceuticals, and 1,476 additional notifications for other goods (25% of all). Again, the method from which these figures are derived is not explained.

All of the calculations seem to be in contrast with the explanatory notes to the legislative proposal, in which the Commission explains that it expects to receive only 35-45 notifications per year.

Q5.2 What about the methodology to estimate the additional administrative burden? How detailed and reliable is the assessment?

The calculations are not described in detail in the Impact Assessment and generally difficult to follow. **All the items included in the assessment of administrative burden seem to be on-going costs, calculated at a per annum basis** (although this is not always mentioned explicitly)**. Apparently no one-off administrative costs have been calculated** (for setting up new internal procedures and templates, procuring legal advice to cope

[40] European Commission (2012) *Public Procurement Indicators 2011.* Available at: http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/public-procurement-indicators-2011_en.pdf

with the new legislation, providing general information on the changes to bidders etc.), although these may be significant. Many authorities are affected: the Commission's Annual Public Procurement Implementation Review for 2012 puts the number of contracting authorities and entities in the EU - on the basis of information received from Member State - at a minimum of 250,000.[41]

The calculations undertaken to estimate the administrative burden on companies, stemming from producing certificates of origin, is not clear and can't be easily reproduced. For instance, for policy options 3A and 3B, the Impact Assessment sets the costs for the certificates of origin at €3,450,000; calculating with €5 for one certificate (690,000 cases). As explained above, the total number of tenders above the EU thresholds published on TED was 168,160 in 2011 (estimated to correspond to close to 500,000 single lots). In case the relevant sectors - computers, fuel, medical equipment and pharmaceuticals – indeed represent 15% of this amount, as written in the impact assessment document, this would correspond to 25,224 tenders (representing at least 80-90,000 lots, considering that especially pharmaceuticals tend to be procured in tenders comprising several lots). On average, each lot receives 6.5 offers[42], therefore the number of certificates required will be around 165,000 per annum if we calculate with one certificate per tender and around 520-580,000 if a certificate is required for each lot. **Even the latter estimate is lower than the number given in the Impact Assessment**.

However, **the cost of time** needed to assemble the information for the certification of origin, assembling, reviewing and authorising it at the company (before requesting certification from the relevant authority) **should probably exceed the calculated €5 by far**. This unit value estimate on the cost to economic operators for one certificate of origin comes from an earlier Impact Assessment on the rules of origin for the Generalised System of Preferences (GSP).[43] A total working time of one hour was estimated in the paper for preparing and requesting the certification of origin for each consignment, which was then multiplied with an average labour cost of €5. Evidently, the average labour cost in GPS beneficiary countries is much lower than in developed industrial economies which are part of the possible target group of the proposed regulation. If staff from European companies is involved, the per unit cost will be considerably higher. The companies may also incur a service fee if e.g. a logistic service provider or freight forwarding agent is commissioned to procure the certificate of origin.

[41] Available at: http://ec.europa.eu/internal_market/publicprocurement/docs/implementation/20121011-staff-working-document_en.pdf

[42] This was estimated on the full database of contract award notices published on TED between 2009 and 2012.

[43] European Commission (2007) Impact assessment on Rules of origin for the Generalised System of Preferences (GSP). TAXUD/C5/RL D(2007). Available at: http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_777_en.htm

For option 3A, the Impact Assessment explains that the obligation to contracting authorities to indicating a possible waiver in the standard forms does not constitute an administrative burden. Even though the standard forms are indeed mandatory, filling out fields that were not included in the past **should be considered a new information obligation and is thus an administrative burden**. If contracting authorities decided to indicate the waiver for all procedures concerning computers, fuel, medical equipment and pharmaceuticals (25,224 tenders above the EU thresholds in 2011 if the 15% ratio assumed in the Impact Assessment is correct) and calculating only with one hour staff time, this would amount to an additional €1.1 million per annum when calculating with the same hourly cost (€44) than the Impact Assessment (under option 3B).

Under option 3B, the Impact Assessment tries to calculate the opportunity cost of time delays. If the waiting time for a Commission decision for a notification case is 6-8 weeks, and if the value of all the concerned contracts had been put in a bank for that period, this yields, with an annual interest rate of 3% a cost estimate of €38 million. **If the volume of underlying goods and services to be procured is at around €8-10 billion** (this assumption or the calculation method is not explained in detail)**, then this calculation is correct and acceptable, although it does not count with opportunity costs to tenderers, including for deposits (if no interest is paid).**

Q5.3 What about the additional costs for each contracting authority in relation to the volume of the public procurement?

The expected number of notification cases is probably overestimated in the Impact Assessment. On the other hand, not all the administrative costs incurring to contracting authorities are considered. The actual additional costs may thus be either lower or higher than the estimates. The method applied assumes a linear relationship between the number of notification cases and costs - hence the relative administrative burden for larger contracts or for contracting authorities that usually tender larger volumes will be smaller. It should be noted that the overall estimated administrative burden on public administration is moderate and should not strongly influence the choice of the preferred policy option.

Q5.4 How sound is the estimate of the number of cases for notification?

As explained in the response to question 5.1, the method for calculating the number of notification cases under the individual policy options is not described elaborately and it was not possible to reconstruct the calculations. **From the information available we can assume a certain degree of overestimation**.

Impact on SMEs

Q6.1 To what extent the impact for SMEs has been evaluated?

One of the general objectives of the legislative proposal is to "boost the internationalisation of SMEs in a globalised economy". However, despite the apparent importance of the topic, there is **little discussion in the Impact Assessment of the impact of policy options on SMEs**.

The problem assessment (the main text and Annex 3) mentions that SMEs face particular difficulties to overcome local establishment and national content requirements in third countries. Establishing a subsidiary abroad comes with technical difficulties and high costs (chiefly costs of legal and tax advisory) relative to the financial means of SMEs – especially micro- and small enterprises - and such an investment would also entail a business risk not commensurate to the revenues expected from the operations. Based on this and other barriers, the Impact Assessment assumes that SMEs cannot participate in third-country public procurement that is not legally committed internationally (where no restrictions can be applied).

The internationalisation of SMEs is also mentioned as a cross-cutting impact, albeit only explaining that the contribution of the policy options to this general objective will depend on the countries and sectors opened up to European companies (better access to the Russian public procurement market is said to be most beneficial for companies from Poland or Bulgaria, which is debatable – highly specialised companies from the leading European economies may have even better opportunities).

The above trends or impacts were not quantified in the document. One of the comments of the Impact Assessment Board to the draft version of the assessment concerned was that the magnitude of the problem for SMEs has not been dimensioned. As explained in Annex 10, this has not been done in the follow-up work either due to lack of available data.

It is indeed very difficult to find relevant data. There is some quantitative evidence that **SMEs' proportion in cross-border procurement is lower than in domestic procurement – even for relatively high-value contracts (subject to GPA)**. Data is only available for the EU27's internal procurement market but the findings here can probably be indicative of third-country procurement. The most recent estimates on SMEs' access to public procurement were published in GHK's 2010 study prepared on behalf of DG Enterprise and Industry.[44] According to these estimates, 60% of all contracts above the EU-thresholds – with a combined value reaching 34% of the total value of above-thresholds

[44] GHK (2010) Evaluation of SMEs' access to public procurement markets in the EU. Prepared for the European Commission. Available at: http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes_access_to_public_procurement_final_report_2010_en.pdf

contracts - were awarded to SMEs (as the single or lead contractor) between 2006 and 2008. An update of the study – using a refined methodology involving more manual checking of company information – is currently undertaken by a consortium including PricewaterhouseCoopers, Ecorys and GHK. First results show that in 2009, SMEs' proportion among companies winning public contracts above the EU-thresholds was 56% for domestic procurement and only 50% for cross-border procurement; in terms of value, SMEs' share in cross-border procurement was only 20%, compared to 28% in domestic procurement.

22% of the identified cross-border contracts awarded to SMEs concerned construction work, 11% the purchase of laboratory, optical and precision equipment, whereas transport equipment (and auxiliary products to transportation) and industrial machinery accounted for 5% each.

Figure 17 – SMEs' share in domestic and (direct) cross-border procurement in the EU, above the thresholds (2009)

	Micro	Small	Medium	SMEs total	Large
Number of contracts					
- domestic	1,441	1,613	1,426	4,480	3,502
- cross-border	31	31	36	98	97
In percentage					
- domestic	18%	20%	18%	56%	44%
- cross-border	16%	16%	18%	50%	50%
Aggregate value of contracts (million euros)					
- domestic	19,916	36,438	47,680	104,034	265,675
- cross-border	232	163	1,132	1,528	6,293
In percentage					
- domestic	5%	10%	13%	28%	72%
- cross-border	3%	2%	14%	20%	80%

Source: Sample of contract award notices published on the EU's procurement portal TED in 2009; size class of winners identified through employment and annual turnover data sourced from Dun&Bradstreet.

The analysis of intra-EU cross-border procurement also confirms that **proximity and a common language are decisive factors in cross-border procurement patterns**: companies are more likely to tender for – and win - contracts in a neighbouring country, especially if the regions concerned are speaking the same language. The assumption that SMEs from countries on the EU's external borders as well as Spain, France, Belgium, Ireland, and the UK (for the common language with many third countries) will benefit the most of market opening is therefore probably correct, although countries with a strong and successful export-oriented SME-sector such as Germany, Italy, the Netherlands, Sweden or Denmark should also be mentioned.

It must be noted, however, that **large value contracts**, especially those above €5,000,000 – the proposed threshold for the application of the new regulation **– are very rarely won by**

SMEs. Data analysis currently undertaken for a study updating the 2010 GHK study on SMEs' access to public procurement market shows that only 16% of contracts above €5,000,000 euro, 13% in terms of combined value, were awarded to an SME (including SME-led consortia). SMEs may of course also benefit from large value contracts as (non-leading) consortium partners, subcontractors or unnamed suppliers.

Interestingly, **SMEs are not mentioned in the Impact Assessment as possible beneficiaries of import replacement** in case bids from third countries are rejected in European public procurement. In fact it can be assumed that the policy options will generate stronger (positive) impacts in this area than in the access to third markets. SMEs are in general much more likely to win public contracts on their domestic market than abroad. This applies also to cases where SMEs work as subcontractors.

The public procurement markets in question are relatively high-value contracts which are normally dominated by large enterprises. For reference, Figure 11 presents the GPA thresholds applicable for EU public procurement. Given the size of contracts, SMEs are probably more likely to be included as subcontractors than winning contracts in third countries on their own. Large enterprises should however more often rely on local SMEs than foreign ones, hence European SMEs will have considerably more business opportunities in domestic public procurement than in a third country.

Figure 18 – Thresholds for the application of the GPA in the EU, in Special Drawing Rights (SDR)

Entities concerned	Supplies	Services	Works
Central government entities	130,000 SDR (ca. 150,000 EUR)	130,000 SDR (ca. 150,000 EUR)	5,000,000 SDR (ca 5,770,000 EUR)
Sub-central government entities	200,000 SDR (ca. 230,000 EUR)	200,000 SDR (ca. 230,000 EUR)	5,000,000 SDR (ca 5,770,000 EUR)
Other entities	400,000 SDR (ca. 460,000 EUR)	400,000 SDR (ca. 460,000 EUR)	5,000,000 SDR (ca 5,770,000 EUR)

Q6.2 Are there some options more beneficial for SMEs than others?

There is a relatively broad consensus among economists that protectionism in most sectors – considering retaliations and the additional burden on economic operators to bypass restrictions - is harmful in the long term to all economies. In the short term, and especially if limited retaliation is expected, barriers to market access of third-country producers or service providers may bring benefits to domestic companies. Under the assumption that European SMEs are much more likely to profit from import replacement (from rejection of third-country bids) than from the opening up of new export markets, **policy options that will bring a greater rejection rate should be more beneficial for domestic SMEs in general – at least those that are not specifically relying on export markets**. According to the Impact Assessment, the two policy options generating the most bid rejection are 3A (about €4.1 billion) and 3C (about €3.1 billion). On the other end

of the scale, the value of rejections for option 4 is only estimated to reach €2 billion and options 2A and 3B only €1 billion. If these estimates are broadly correct, and if the level of retaliation does not significantly exceed assumptions, policy options 3A and 3C should be more beneficial for European SMEs, at least in the short term. Exceptions are SMEs that specifically target third country markets.

Figure 19 – Estimated volume of rejected import under the policy options

	2A	3A	3B	3C	4
Volume of import rejected	€1 bn	€4.1 bn	€1 bn	€3.1 bn	€2 bn

Source: Impact Assessment

Justification of thresholds

Q7.1 Has the 5 Mio. EURO threshold been assessed? Have the reasons in terms of cost and benefits been assessed for setting up this threshold?

Article 6 of the legislative proposal defines the threshold for applying the new procedures (exclusion of tenders from third countries) at €5,000,000. This is the same threshold than set out for the EU27 in the GPA for public works**; it does however exceed the GPA-thresholds for supplies and services by a wide margin** (the thresholds are for both €130,000-400,000, depending on the type of authority). The number of tenders above this proposed threshold account for about 7% of all EU procurement published in the Official Journal, and its combined value accounts for about 61% of the total procurement market above the EU-thresholds.

The Impact Assessment has apparently made no attempt to assess these or other optional thresholds (for instance, lower levels for supplies and services) or the related costs and benefits. Theoretically, pushing the threshold down the GPA-thresholds would result in a situation where the overwhelming majority of procurement above the EU-thresholds would be subject to the new legislation – this would have beneficial impacts on SMEs focusing on the domestic market as third-country competitors might be rejected for many lower-value contracts which are more accessible for SMEs. On the other hand, applying very low thresholds would be probably seen as unreasonably strict by the EU's trading partners and elicit more retaliatory actions, hurting exporting industries (first and foremost exporting SMES, but also large companies – even though the latter have better opportunities circumventing restrictions through local affiliates).

Q7.2 Is the estimation of the number of notification cases correct?

As explained in the response to question 5.1, the method for calculating the number of notification cases under the individual policy options is not described elaborately and it was not possible to reconstruct the calculations. **From the information available we can assume a certain degree of overestimation**.

Existing national legislation restricting access to public procurement markets (p.m.)[45]

Q8.1 Is there any more detailed information available on the existing national and regional legislation restricting access to public procurement markets?(p.m.)

Q8.2 Which mechanisms have been put in place and can any lessons be drawn from this legislation? (p.m.)

[45] This topic, addressed in other expert papers, is here *pour mémoire* for congruence with the structure of the questions requested by INTA.

Detailed appraisal
of the European Commission's Impact Assessment

Rules concerning third countries' reciprocal access to EU public procurement

Commission proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries (COM(2012) 124 final)

ANNEX III

SME related impacts, thresholds and national legislation

Research paper
by Pedro Telles

Abstract

Direct benefits for SMEs from the proposed Regulation look limited at best, while indirect impacts appear probable. The 5 Mio EUR proposed for the threshold is similar to pre-existing public procurement thresholds and implies that only a small subset of contracts will be covered by the regulation which may impact its effectiveness. Contracting authorities have no incentive to refer procedures to the Commission. Spain has reciprocity clauses but there is no evidence of their widespread use.

AUTHOR
This study has been written by **Dr. Pedro Telles** of **Bangor University** at the request of the Impact Assessment Unit of the Directorate for Impact Assessment and European Added Value, within the Directorate General for Internal Policies (DG IPOL) of the General Secretariat of the European Parliament, following a request of the Committee on International Trade (INTA)

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Contents

Executive summary

European SMEs tend to bid mostly for public procurement contracts within their home Member State and for small contracts. Participation rates of SMEs in cross-border procurement appear lower than their overall participation on the economy. The Regulation proposed by the European Commission will target contracts over 5 Mio Eur with a view of forcing the opening of public procurement markets in third countries. The direct benefits for European SMEs will be limited if any at all. If indeed public procurement markets are opened in the future, the potential benefits for SMEs will mostly be available through sub-contracting and supply chain opportunities, areas that third countries can easily close down with *de facto* protectionist measures.

Some impacts on SMEs of the proposed Regulation do not appear to have been taken into consideration. Any SME participating directly (tenderers) or indirectly (sub-contractors, supply chain) in the procedure will face transaction and opportunity costs due to the four to eight week timeframes for decisions and any possible legal challenge.

All the solutions proposed by the European Commission could potentially lead to retaliation from third countries and it is impossible to map out their entire scope. Furthermore, irrespective of the solution adopted, it is not certain that retaliation would only happen in the same public procurement markets. It is entirely possible that an aggrieved third country could simply decide to retaliate on other trade areas with direct impact on the European SMEs in that market. This may be the biggest risk for EU companies as it could impact export led companies and even the operations of companies inside Europe.

From the perspective of SMEs, other than maintaining the *status quo*, all options considered by the European Commission imply transaction and opportunity costs. However, had the European Commission adopted option 3A (legislative approach without supervision) instead of 3B it would have at least reduced the timescales involved and the number of decisions that may be subject to judicial review. The European Commission could have also considered the option adopted in some Member States of targeting the origin of the bidders and not the origin of the goods or services and again some transaction and opportunity costs for SMEs could be avoided as long as it did not imply a supervision procedure.

The proposed 5 Mio Eur threshold for the Regulation is similar to some of the current thresholds applicable to European public procurement. By covering only a small number of strategic contracts, it will reduce the transaction costs for contracting authorities and the European Commission but may put at risk the effectiveness of the measure. If the threat is not credible because it is seldom used, how will it force any trading partner to negotiate? On the other hand, by reducing the scope of the application of this measure the risks for retaliation are reduced.

On the Impact Assessment working document the European Commission is forecasting 554 yearly referrals of public procurement procedures. This may prove to be too ambitious, as contracting authorities have no incentive to refer a public procurement procedure to the European Commission. This is due to the fact the costs of doing so are certain, i.e. delays in the procedure, risk and cost associated with a judicial review or a weaker field of candidates, whereas there is no obvious benefit for the contracting authority. Therefore it is quite possible the actual number of notifications will be lower than anticipated.

The exception to the previous reservation will probably be strategic or sensitive contracts where the contracting authority may have an interest in having it awarded to a national supplier. In that case, there is a risk the proposed Regulation will be used simply for protectionist purposes and it is as likely that the target of the referral will be either based on another Member State or on a third country.

Some Member States have developed specific "local mechanisms" that led different kinds of national reciprocity clauses: i) excluding suppliers due to their origin (Austria, Italy and Spain); ii) excluding tenders due to the origin of goods (Belgium); iii) exclusion of access to remedies (United Kingdom).

There is no evidence of widespread actual use of reciprocity clauses in the Member States that have them, nor are they a current topic in academic discussions or subject to abundant case law. This lack of evidence of use or interest appears to be the key lesson to be drawn: without incentives contracting authorities will not exclude foreign bidders.

No evidence has been found that the United Kingdom has a reciprocity clause other than an apparent restriction imposed in the access to remedies by suppliers based in third countries. Furthermore, in 2012 the UK Government has spoken against the proposed Regulation in no uncertain terms citing the risk of escalating protectionism.

1. Impact on SMEs

I – SMEs and public procurement

Participation by SMEs in public procurement has been seen for some time as an important goal within the internal market (European Commission, 2010 and European Commission, 2007) but so far have not entirely realised their potential. Between 2006 and 2008 SMEs captured over 60% of contracts but only 33% of the value for contracts above the EU thresholds. The share of value secured by SMEs is between 14% and 21% lower than their weight in the European economy, particularly for micro and small enterprises.

The current figures highlighted above are similar to the ones found for the period between 2002 and 2005 (European Commission, 2007). This indicates two important points for this report:

i) The capacity for SMEs to win public contracts above the thresholds within the EU is plateauing;
ii) SMEs tend to win the contracts with smaller value above EU thresholds.

When taken together, these findings point out towards a rule of thumb regarding the participation of SMEs in public procurement: the larger the contract, the less likely a SME will be able to capture it. It is important to take this into consideration when talking about SME participation in public procurement, particularly for contracts above 5 Mio EUR, which is the threshold proposed by the Commission in the proposal being analysed.

The EU thresholds currently have an established range from 130,000 EUR (certain services and goods) to 5 Mio EUR (works), thus meaning that only the contracts over those thresholds are harmonised under EU law. Contracts beneath these thresholds are not harmonised and, with some caveats such as the cross-border interest test, it is up to each Member State to regulate them.

By looking at the numbers, it is apparent that the bulk of EU rules do not apply to the contracts of the size most SMEs would be interested in competing for. The higher the value of the contract the higher the transaction and opportunity costs for a SME. When taken together, these two put a small company at a disadvantage in comparison with bigger tenderers. Furthermore, larger contracts tend to be tendered through restricted procedure or competitive dialogue which are biased against new or smaller firms due to the need to pick a pre-determined number of candidates based on their prior experience or financial capacity.

In addition, the current thresholds and other exclusions leave out 81.4% of the total procurement spend of the bulk of EU regulation. That is, the current procurement rules and as a consequence the GPA, only cover a small percentage of the total procurement spend.

In some Member States, such as the United Kingdom, participation of SMEs in public procurement has led to the realisation that the only way to increase their spend capture would be by increasing the advertising of lower value contracts and making them more transparent. This was requested by SMEs (Welsh Government, 2009) and implemented by the UK Government in 2011 through the creation of the portal ContractsFinder and the obligation of contracts over circa 12 000 EUR tendered by certain contracting authorities to be widely advertised. Between 2009/10 and 2011/12 the percentage of total direct procurement spend with SMEs grew from 6.5% to 13.7%, with an aspiration of reaching 25% by 2015 (Cabinet Office, 2012).

Taking into consideration the data provided above it appears that within national markets SMEs prefer and are more successful in smaller rather than larger contracts. Furthermore, regulatory and policy changes can foster their participation in procurement markets. This should be taken into account when looking into the impact of the proposed procurement opening policy, particularly as it will affect only contracts over 5 Mio Eur.

Regarding the participation of SMEs in cross-border procurement in Europe the data is less clear but a number of baselines from available research (European Commission, 2010a) may be drawn upon. The first one is that overall cross-border procurement in Europe is the exception and not the rule: only 1.5% of the total number of contracts covered by EU regulations are won by firms based in a different Member State. These contracts represent 3.4% of the procurement spend, once again indicating that they tend to be of a larger size and therefore of less interest to SMEs. Taking into account the conclusion of the previous point, it is probable that SMEs are under-represented in that percentage. If European SMEs appear not to be taking part nor winning public contracts in other Member States how can we expect them to win business in third countries?

Furthermore, the barriers to SMEs participation in foreign public procurement markets across Europe are well known: difficulty to establishing subsidiaries, adapting to different legal regimes and the need to do business in a foreign language. These are recognised by the Commission in the Impact Assessment document accompanying the proposed Regulation. They can be distilled into the higher transaction and opportunity costs of bidding for public procurement contracts abroad, which serve as a deterrent for SME participation. As only larger contracts are covered by EU regulations and as such widely advertised, it is again arguable that the current regulation of public procurement in Europe does not have a large effect on SMEs in terms of cross-border procurement.

The proposed Regulation does not address any of the issues previously identified and as such it is likely that its immediate impact on the participation of SMEs in public procurement at national, cross-border or international level will be limited even if the objective of opening other procurement markets is successful. In other words, if there are any immediate beneficiaries from the proposed Regulation, it will not be European SMEs. Regarding the negative impacts however, the answer is different as they can affect SMEs in many different ways (see next section).

II – To what extent has the impact for SMEs been evaluated?

The Impact Assessment working document looks briefly into the potential impact of the proposed Regulation for SMEs. Its focus is mostly on the difficulties facing SMEs in public procurement (Impact assessment p.18) and the opportunities arising from negotiations downstream for the opening of new public procurement markets (Impact assessment p.28) if negotiations with third countries are successful (SME internationalisation). Looking at the arguments provided, it seems plausible that some European SMEs will benefit in specific sectors and countries if this regulation indeed leads to the opening of new markets. The examples put forward of Portuguese SMEs in Brazil or Polish SMEs in Russia appear reasonable as at least in the first case the language and legal regimes are similar enough to justify the argument. However, no clear evidence of such benefits is provided in the Impact Assessment.

In addition, those are *indirect* benefits that *could* be accrued by SMEs. Looking at the limited success of cross-border procurement wins by SMEs within Europe it is apparent that subsequent issues such as the language and legal requirements of the third countries would have to be solved before European SMEs could reap the benefits of the opening of new markets. These are uncertain long-term benefits.

If the Regulation was indeed successful in the opening of new public procurement markets, perhaps that the biggest potential benefit for SMEs might be through the supply chain of those larger contracts in third countries. This is an area that the Impact Assessment working document does not shed light on unfortunately. One could argue against this potential benefit in that it is one thing to open the procurement market (i.e. the process that results in the choice of the contractor) and another the full blown opening of sub-contracting or supply chain possibilities underneath. It is not farfetched to imagine a situation whereby a third country could open a certain procurement market but would keep trade barriers in place to ensure that local supply chains would benefit from downstream work opportunities. This would not be covered by procurement related agreements and does not seem to have been taken into equation in the case made for the proposed Regulation.

As mentioned in the Impact Assessment working document it is possible that third countries will retaliate on the procurement access offered to European suppliers before starting any negotiations to strengthen their negotiating position. As such, European SMEs already involved in public procurement may lose the access they currently enjoy, either through direct participation or sub-contracting and supply chain opportunities on larger contracts. As mentioned before, participation of SMEs outside their home country is limited even within Europe but it is not unreal to foresee that in specific sectors there may be SMEs directly affected by any retaliation measure.

The Impact Assessment working document does not refer to two important general impacts that affect SMEs as well: i) inward impact, i.e. the impact that SMEs would face within Europe if the Regulation goes ahead; ii) the risk of retaliation outside public procurement.

1.1 Inward impacts

i) Increased timescales on public procurement procedures subject to the notification procedure

In accordance with article 6(3) of the proposed Regulation, contracting authorities will have to notify the Commission of an intention to exclude a supplier. The Commission will have to produce a decision within two or four months of receiving the notification. In consequence, a procedure affected by a notification can be delayed for a period of up to four months. Any SME involved in the procedure either as a tenderer (unlikely due to the high threshold value, unless if part of a consortium), sub-contractor or part of the supply chain of any of the tenderers involved will suffer the same delays. It should be mentioned again that transaction and opportunity costs in public procurement are felt more strongly by SMEs and any delays to the conclusion of a procurement process will affect them more than larger companies. As the procedure will be stopped for a certain period of time, all tenderers, sub-contractors and supply chains will be affected and not only the ones involved in the tender will be subject to potential exclusion. Therefore, the suggestion of an opportunity cost of 3% for 6-8 weeks of delay on the tenderers affected (Impact Assessment working document footnote 104) seems reasonable for larger companies but understates the downstream costs on sub-contractors and supply chains. These are the areas where the potential cost impacts for SMEs may be higher.

ii) Further delays due to legal challenges

In addition to the above, the creation of a new key decision within a procurement procedure will also open the possibility for legal challenges to be brought by any of the tenderers. For example, the tenderer facing exclusion may certainly appeal the decision taken by the Commission and will have access to the full remedy system available within the European public procurement legal framework. It will be entitled to apply for an interim suspension of the decision or the judicial review which would further delay the procedure.

Furthermore, it will provide the other tenderers with two opportunities to bring legal proceedings as well. Firstly, if the Commission decision is negative the remaining tenderers may decide to apply for judicial review of the decision. Secondly, if the contracting authority decides not to refer a tender to the Commission for exclusion, any of the remaining tenderers may also bring judicial review against such decision.

The risk for legal challenges will depend on the culture of each country and the specific circumstances of the tender. For example, legal challenges in public procurement are quite common in countries such as Portugal, Spain or Greece but uncommon in other Member States such as the United Kingdom or Denmark due to cost or the cultural issues.

1.2 Retaliation by third countries outside public procurement

Third countries affected by the proposed regulation may also decide to retaliate outside the field of public procurement in a more general trade dispute. There is no reason to assume that any retaliation will be done on a like for like basis. In the view of the author this poses a major risk that is underrepresented in the Impact Assessment working paper.

If a third country wants to maximise the effect of their retaliation, it may be that the most beneficial way for it to do so will be to target a completely different market. The obvious targets would be sectors where European suppliers (including exporting SMEs) are already operating and could stand to lose the access they currently enjoy. For example, in a scenario based on the construction sector where the steel being procured for the construction of a bridge is coming from a third country without a GPA agreement, if the Commission decides to exclude the tenderer the third country might retaliate by banning imports from European suppliers in the car industry or stop selling rare earth minerals to European buyers. Any SME operating directly or indirectly on these sectors could potentially be affected, including SMEs depending on inputs coming from third countries. In other words, not only the external market would be at risk but also the ability of European companies to keep operating at all in case their own supply chain is affected.

The legality of such retaliation may be disputed under WTO regulations but it would not be impossible for this to happen and it would take a number of years to go through the appropriate WTO mechanisms to solve the issue.

III – Are there some options more beneficial for SMEs than others?

The European Commission presented a number of different options before adopting solution 3B, that is, a legislative approach with supervision by the European Commission. All options involved trade offs and the case presented can be understood with the caveat that no hard data was provided but only the subjective impressions that led to the decision taken.

It is hard, if not impossible, to identify all the risks and possible consequences of any of the options provided due to the unlimited dependencies and the fact that the actual consequences will depend on the reactions from affected third countries. It is assumed that the overall impact will be dealt with in more detail in another of the areas of the questionnaire provided.

Although it is not advisable to focus the decision making process on the impact on a single group of stakeholders or beneficiaries, it is still relevant to look at what might be the consequences of the different options originally proposed on SMEs.

From the perspective of SMEs, the option adopted can lead to the aforementioned direct and indirect impacts and costs. However, it would appear that all other options have similar drawbacks. As the objective is to inflict some financial pain on third countries, any of the solutions to achieve this aim can lead to retaliation either on the original market of the dispute or on a completely different market. It is quite possible that any

option, to be effective, will impose transactions costs directly and bears the risk the effect of retaliation will be borne by unforeseen victims, including European SMEs.

It can be said however that any option (legislative or not) that did not include supervision by the European Commission would reduce but not eliminate potential negative impacts on European SMEs. For example, solution 3A, a legislative approach without supervision by the European Commission would trade the delay imposed by the two to four month decision timeframe with the possibility of more contracting authorities unilaterally deciding to exclude suppliers falling into the conditions imposed by the Regulation, particularly if said suppliers were foreign, i.e. based on other Member States or from third countries.

In addition to solution 3A, another option that might reduce the transaction costs for SMEs would be to adopt an approach similar to the one taken currently in Austria, Italy or Spain (please see last question) where the exclusion depends on the place of incorporation of the company. If this was a simply mandatory condition as currently imposed in some Member States without interference by the Commission, only foreign bidders would be excluded and at least some of the transaction costs could have been avoided.

Key findings

- European SMEs tend to bid for contracts much lower than the proposed threshold of 5 Mio Eur by the Regulation and they do not take part directly in most contracts covered by it. Any SMEs participating in supply chain or sub-contracting roles in tenders subject to the notification procedure would still be affected.
- Cross-border SME procurement participation is limited and Regulation does not address any of the already identified cross-border barriers, as such it is unlikely to have a direct positive impact for SMEs.
- Direct benefits for SMEs from the proposed Regulation other than supply chain opportunities on larger contracts tendered in third countries seem limited and even those are uncertain.
- Inward impact of Regulation has not been thoroughly explored in the Impact Assessment working document and potential impacts not originally forecast can be anticipated.
- Risk of retaliation outside public procurement by third countries has not been taken into consideration. This poses the biggest risk for EU businesses including SMEs
- All solutions proposed by the European Commission could lead to retaliation and other impacts on SMEs, but it is impossible to measure them with precision.
- From a perspective of the transaction costs for SMEs, option 3A (legislative approach without supervision by the Commission) or a system like the one currently in place in Austria, Italy or Spain that targets the origin of the supplier itself would potentially affect less European SMEs. That does not mean that these would be overall better tools to achieve the stated aim of forcing third countries to negotiate access to public procurement.

2. Justification of thresholds

I – Has the 5 Mio EURO threshold been assessed?

There is some logic behind choosing a single threshold instead of multiple ones for the application of the proposed Regulation. Having multiple thresholds, as it occurs within European public procurement, where there are different thresholds for different types of contracts and contracting authorities would increase the complexity and the compliance costs with the new Regulation. It could be argued however that if the objective was indeed for the Regulation to be applied in practice it would have been preferable to simply adopt the current multiple thresholds in force, as they cover many more contracts.

The 5 Mio Eur threshold appears to be aligned with existing relevant thresholds in public procurement. For the award of works contracts covered by the Directives 2004/18 and 2004/17 the threshold is also 5 Mio Euro. In addition, the GPA thresholds for works tendered by contracting authorities covered by Annex 1 (central purchasing bodies) or Annex 3 (state owned enterprises and utilities) is 5 Mio SDR, which amounts to around 4 Mio Eur. Therefore, by adopting a 5 Mio Eur threshold it is guaranteed that only contracts that are subject to the general EU procurement rules will be subject to this Regulation as well.

The value of 5 Mio Eur indicates that the proposed Regulation is not to be used very often in practice, as recognised by the European Commission on the suggested yearly notification numbers. This raises a question surrounding the effectiveness of this measure. To be effective, a threat needs to be used. Without a real threat of use it may simply be irrelevant as a tool to force third countries to negotiate the opening of their procurement markets directly. Even so, it may be a useful "bargaining chip" in more encompassing trade negotiations, something that is not put forward directly by the European Commission. For example, by having this Regulation in place it is possible to force a discussion on public procurement in general trade negotiations and be offered as a concession even if it has not been used many times against suppliers from a specific third country.

It is unclear whether this specific threshold has been assessed but it would appear it has been chosen as a compromise: it is high enough that will only apply to a limited subset of strategic contracts and with a value similar to already existing EU public procurement thresholds, thus limiting the compliance costs both to contracting authorities and to the European Commission.

II – Have the reasons in terms of cost and benefits been assessed for setting up this threshold?

Choosing a threshold value for the proposed Regulation implies a degree of trade offs between competing interests as argued above. On the one hand, there is the ultimate objective of using it as a bargaining chip for future negotiations and for that to happen

the Regulation needs to be effective or at least *appear* to be effective and being applied in practice. Otherwise it will be a proverbial "paper tiger". On the other hand, the consequences and implications for participants in public procurement (contracting authorities, suppliers and the European Commission to a certain extent) need to be taken into account.

The European Commission estimates that there will be 554 notifications a year for the exclusion of tenders. The potential implications in terms of administrative burden are well established in the Impact Assessment working document assuming the number of notifications comes near the estimates (please see next question). If the Regulation was applicable to lower value contracts the number of notifications would necessarily be higher, increasing the transaction costs both for the contracting authority, the European Commission and suppliers taking part directly or indirectly (sub-contractors or supply chain) in the procedure. By having a lower threshold the number of notices could increase exponentially as a much higher percentage of contracts would potentially be covered. In other words it would not be focused on strategic procurement exercises but would lead to an increased number of referrals, perhaps with an increase in the efficiency (leverage) of the Regulation in future trade negotiations. A larger number of referrals would also imply that more third countries would be affected and increase the risk of retaliations.

The opposite is also reasonable. A higher threshold value would lead to a situation with only the proverbial "tip of the iceberg" of only a limited number of cases being potentially covered. As such, if only a limited number of notices were pushed every year the Regulation would not create any leverage over our trading partners.

It is not clear from the Impact Assessment working document or the Regulation in itself if the specific threshold of 5 Mio Eur was chosen as a value that would keep the negative impacts (transaction and opportunity costs) low while maximising the efficiency of the Regulation or if it was chosen as a benchmark value similar to threshold values already existing in public procurement.

III – Is the estimation of the number of notification cases correct?

The European Commission estimates that the Regulation will yield around 550 notifications yearly across all Member States. Forecasting how people will respond to future regulation is not an exact science and the case presented by the European Commission does not detail the assumptions that lead to the proposed number. However, some points are worth noting, particularly the issue surrounding incentives. The key question to pose on this issue is what is the incentive for someone to make the decision of referring a procurement procedure to the European Commission?

People react to incentives. For the contracting authority the regulation implies a certainty: extra transaction costs due to the compliance costs and the round trip of the notification

to the European Commission. In addition, it will have to factor in the risk that the decision may be challenged in court, further delaying the procurement procedure. What, then, is the incentive for a procurer to a) disclose on the tender documents the faculty of excluding a tender; b) spend time assessing all the documentation and certificates on all bids received to see if any should be referred; c) wait six to eight weeks for a reply from the European Commission; d) face the risk of having the process derailed with a judicial review; e) be left with a weaker field of candidates, thus potentially leaving it with a poorer choice? The upside for a procurer is negligible while the downside, particularly in terms of reputation risk for both the authority and the individual person leading the procurement procedure is quite tangible.

There is only one situation where all the drawbacks of the regulation may be put aside and that is if there is pressure within the contracting authority, namely political pressure, to exclude a bid from a foreigner supplier. By foreigner it is meant both a bid coming from outside the EU (the proposed target of a Regulation) and also a bid coming from a company based in another Member State. There is a clear danger that this Regulation may be used as a protectionist tool against all foreign bids and not only the ones from third countries as intentioned. As it stands, the 50% test imposed by Regulation is focused on the goods or services being supplied by the bidder and not the bidder nationality. As such, any European bidder using inputs coming from third countries is at risk of this Regulation. This risk can be minimised by amending the Regulation to make it clear that it is applicable to suppliers based on third countries only. However, this minimisation strategy introduces new risks, namely that third country suppliers will use European companies as "straw men" when bidding or will create special vehicles either in Europe or in countries not affected by the Regulation (i.e., GPA countries for example) to side step it (please see next question).

The higher the value and the visibility of the contract the bigger the incentive to use any tool available, even if illegally, to ensure the contract is won by a national firm. This is not a farfetched scenario. For example, in a situation where a national supplier and one based on another Member State present bids that would fall under the conditions imposed by the regulation for potential exclusion, it is entirely possible that the contracting authority will refer only the foreign bid to the Commission. The counter-argument would be that this would violate the principle of equal treatment (it does) but how would anyone know that if only the contracting authority has access to both bids? Unless the foreign bidder has a good knowledge of the competition he may not be in a position to argue that both bids should have been referred. This risk is not addressed by the European Commission on the Impact Assessment working document.

Key findings

- The 5 Mio Eur threshold is similar to some of the current thresholds for the application of EU public procurement rules. It will cover a limited number of contracts which may reduce its effect as a credible threat to force third countries to open their procurement markets.
- The proposed threshold seems to be a compromise between having a threat in place and the transaction costs imposed on contracting authorities and the European Commission by being applicable to a small number of strategic contracts.
- A lower threshold would increase the transaction costs for all involved (contracting authorities, direct and indirect suppliers and the European Commission) but at the same time make a more credible threat to third countries. As a consequence, however, retaliation would be more likely.
- The estimated number of 554 notification cases per year seems ambitious. The lack of incentives for contracting authorities to refer a procedure to the European Commission do not appear to have been tackled. Referring a procedure incurs on costs and downsides that are certain without any visible benefit for the contracting authority.
- There is a danger that this Regulation will be used for protectionist purposes, not only against bidders based in third countries but also bidders based in other Member States, particularly on larger contracts. At a cost, this risk can be minimised by amending the proposed Regulation as to apply the 50% test only to suppliers based in third countries. On the other hand, this would open the door to third country bidders using European companies as "straw men" or complex company structures to sidestep this solution.

3. National legislation restricting access to public procurement

I – Is there any more detailed information available on the existing national and regional legislation restricting access to public procurement?

The Impact Assessment working document put forward by the European Commission states that some Member States have created national regimes for the exclusion of tenders coming from tenderers based outside the European Union. The approaches taken by these pieces of legislation vary from country to country but may provide some interesting insights to potential use of the reciprocity clauses with the caveat of the widespread lack of data or reliable information on their use. This limitation has already been pointed out on the Impact Assessment working document. It should be noted that, in general, third country access is not perceived to be a leading public procurement issue discussed either in national academic circles or subject to significant national case law.

It is possible to organise the ways Member States have imposed reciprocity clauses in three different approaches: i) excluding suppliers due to their origin; ii) excluding tenders due to the origin of goods; iii) exclusion of access to remedies.

1. **Excluding suppliers due to their origin (Austria, Italy and Spain)**

Under this approach to reciprocity, Member States provide contracting authorities with the possibility of excluding companies based on their place of incorporation. As such, a Chinese company can be barred from taking part on a procurement procedure just due to the fact of being incorporated in that country. In some Member States such as Austria (and perhaps Spain), contracting authorities have the discretion to exclude or not companies based on third countries. In Italy, however, the law leaves no scope whatsoever for the contracting authority to make a decision to accept the participation of a company incorporated in a country not party to the GPA or specific trade agreements.

In comparison with the approach taken by the proposed Regulation, the exclusion of companies due to their origin has benefits and drawbacks. On the benefits side it provides more certainty to the contracting authority than assessing the origin of goods. It reduces uncertainty in the process as a simple transcript of the companies registrar will suffice for the decision to be made. In addition, this approach cannot be used as a protectionist tool against bidders based on other Member States, unless they are part of a consortium that includes members from a third country. On the other hand, as argued in the previous question, this is a system that can easily be defeated simply through the creation of a vehicle on any Member State or country party to the GPA or a trade deal covering public procurement. For example, the Chinese company could just incorporate a subsidiary in Germany or Canada to tender for contracts in Austria, Italy or Spain. In alternative, in contracts where technical or financial requirements are substantial it could enter an agreement with a European partner to use it as a front on the bidding or an existing subsidiary. Either way, these provisions are easily defeatable.

Although at least in Italy the contracting authority is obliged to exclude suppliers incorporated in third countries not covered by the GPA or trade agreements, there is limited evidence of the use in practice of this provision. For example, it appears that only one foreign company has taken this matter to the Italian courts so far (the company lost the appeal).

The actual use of these exclusions is even more limited where the contracting authorities have the discretion to exclude companies or not, for example in Austria and arguably in Spain. In Austria, anecdotal evidence has pointed to the limited use of this tool although it appears to be on the rise (albeit from a small base). There are not, however, reliable statistics available to provide a more certain answer. In Spain, both the national and a regional (Navarra) legislation allow for the exclusion of suppliers and there are no known cases of this provision being applied in practice. That does not mean it has not been used but there is a lack of doctrinal discussion or case law on this topic. Furthermore, even the various procurement advisory bodies in the country have not been asked to provide any guidance either.

This lack of evidence in various EU Member States with simple reciprocity clauses based on the origin of the supplier which cover most of their procurement (goods, services and works with values well under the 5 Mio Eur threshold of the proposed Regulation) seems to support the argument made on the previous question: without incentives, few contracting authorities will resort to exclude foreign bidders on the basis of reciprocal access to procurement markets.

2. Excluding tenders due to origin of goods (Belgium)

Other Member States such as Belgium have introduced legislation barring bidders from taking part on a public procurement procedure where a certain percentage of the goods provided is coming from the countries not party to the GPA or specific trade agreements. In other words, they have extended the current rules applicable to the utilities sector to all public procurement. In comparison with the proposed Regulation it is worth noting some differences.

The first difference is that there is no report process to an external authority. The contracting authority takes the decision and it can be challenged in the courts, but is not vetoed or approved by any other body as the Commission is proposing to do. This makes the process simpler and faster as it avoids the delay involved with a second decision maker.

Secondly, these rules are applicable to any goods supply or mixed contract covered by the legislation. As such they will cover a larger number of contracts by being applicable to contracts with a value well below the 5 Mio Eur threshold set in the proposed Regulation.

As mentioned in the Impact Assessment working document, the situation in practice in Belgium is unclear as the 2006 public procurement law was expected to come into force only in next July. In any case, the provision was already present in the previous 1993 law but no evidence of its widespread use was possible to be found.

3. Exclusion of remedies access (United Kingdom)

Although not technically an issue of access to public procurement markets by third country suppliers, the Impact Assessment working document refers to the United Kingdom, where the current public procurement remedies legislation appear to exclude the access to the remedies system to suppliers based outside the EU or a GPA signatory party. The Impact Assessment refers to the existence of case law in the UK which however was not possible to be found or analysed. The working document also correctly mentions that in any case the use of remedies in the UK is quite limited in general. However, particularly in Northern Ireland, the use has been increasing over the last few years albeit from a very small base.

On a literal reading of section 47B of the Public Contracts Regulation 2006 (as amended by the Public Contracts (Amendment) Regulation 2009) it appears to limit the access to the remedies system to suppliers based on GPA signatory parties. There are some reasonable grounds of uncertainty and the actual implications of these rules can be disputed.

The Impact Assessment working document appears to take a literal reading of the UK law as excluding any non-EU or GPA based supplier access to the remedies regime. However, this literal reading disregards two important points. Firstly, it would violate the principle of equal treatment as some bidders accepted to the tender would have access to means of redress whereas others would be excluded just due to their country of origin. It would be one thing for the law to allow the exclusion of tenderers from the start based on their origin, as it is possible on some Member States, another to treat it differently after he has been accepted to the tender.

Secondly, the literal reading implies also excluding suppliers from countries with trade agreements with the EU or the UK but that are not party to the GPA, such as Chile and Mexico.

In addition to the above reservations, the Cabinet Office has produced a public procurement policy note in April 2012 (Cabinet Office, 2012a) criticising the proposed Regulation as following a "tit for tat" approach that would lead to protectionism and would not be conducive to the objective of opening the public procurement markets. This appears to imply a very strong political view not only against the current Regulation proposal but also against the protectionist spirit it seems to embody. As such, it would not be surprising if the remedies rules would be amended as to make them clearly applicable to all tenderers in case they have really been applied as a discriminatory measure against bidders from third countries.

II – Which mechanisms have been put in place and can any lessons be drawn from this legislation?

From the previous section it is apparent that three different mechanisms have been used to restrict market access or the access to remedies by suppliers based in third countries: i) excluding suppliers due to their origin; ii) excluding tenders due to origin of goods; iii) exclusion of remedies access.

There is no clear evidence that at least in Austria, Italy and Spain there has been an extensive use of reciprocity clauses. In Austria and Italy there is evidence of occasional use only but without any clear data or information that could be of use to draw lessons from such use. There is also no evidence that many complaints have come forward through the judicial review systems of these three countries.

A specific lesson from the apparent lack of use of reciprocity clauses can be derived though. As argued in the question regarding the threshold value, even when contracting authorities are left with a fairly broad discretion to exclude a bidder it is not certain that they will do so if incentives are not there. It is likely that contracting authorities in the Member States analysed simply see no benefit to excluding tenderers taking part in public procurement procedures.

In addition to the above, regarding Spain, as this is a country where access to judicial review in public procurement is relatively easy for aggrieved bidders, there is actually an incentive for contracting authorities not to exclude tenderers in general (and specifically on reciprocity grounds). This ease of access to the remedies system leads to risk averse strategies that minimise the risk of challenges during the process. Not excluding candidates is a way to reduce the risks of challenges. In what concerns reciprocity clauses, the ease of access to remedies and the duration of judicial procedures may actually function as a deterrent against their use.

Another lesson can be derived from the way Member States have introduced reciprocity clauses in their national legislation. There appears to be a preference for targeting suppliers themselves and not the origin of the goods being supplied. This is different from the proposed Regulation where the deciding factor for exclusion is the origin of the goods. This may be a relevant point for analysis as it avoids the problem identified earlier with the proposed Regulation. By targeting the origin of inputs and not the supplier itself, the proposed Regulation may be used for protectionist purposes against suppliers based on other Member States. This risk does not occur with the current national reciprocity clauses as only suppliers from third countries not covered by the GPA or trade agreements are affected. However, as argued before, the national reciprocity clauses can easily be side stepped by simply using a subsidiary based on any Member State. For very large companies with subsidiaries it should be easy to just use an existing one based somewhere in Europe. Even for medium sized companies it may be reasonably easy to just create a vehicle in a Member State just for the purposes of tendering within the EU Member States with a reciprocity clause that targets the origin of the supplier.

Key findings

- The local mechanisms developed by EU Member States lead to three different kinds of reciprocity clauses: i) excluding suppliers due to their origin (Austria, Italy and Spain); ii) excluding tenders due to the origin of goods (Belgium); iii) exclusion of access to remedies (United Kingdom).
- There is no evidence of widespread use of reciprocity clauses in Member States such as Austria, Italy or Spain. In the first two cases the use seems limited and in the third non-existent.
- The lack of evidence of the use of reciprocity clauses appears to be the key lesson to be drawn from this legislation: without incentives contracting authorities will not be excluding foreign bidders.
- No evidence that the United Kingdom has a reciprocity clause other than apparent restriction imposed in the access to remedies by suppliers based in third countries. Furthermore, the Government has spoken against the proposed Regulation in no uncertain terms.
- National reciprocity clauses (Austria, Italy and Spain) appear to target the origin of the supplier and not the origin of the goods being supplied as it is the case with the proposed Regulation. This approach avoids the risk of being used for protectionist purposes against bidders based on other Member States but can easily be avoided by the creation of subsidiaries or similar strategies.

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Detailed appraisal
of the European Commission's Impact Assessment

Rules concerning third countries' reciprocal access to EU public procurement

Commission proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries (COM(2012) 124 final)

ANNEX IV

Game theory considerations

Research paper
by Nicola Dimitri

Abstract

Focusing on some main strategic themes, underlying the EU and third countries interaction in public procurement markets (PPM), within a very stylised game theory framework a main message of the paper suggests that open PPM may be more likely when, in the parties' negotiations, the perspective of contracting authorities prevails on that of the business firms. We then discuss conditions under which also a business firms' perspective may enhance reciprocated open PPM. Based on the analysis the paper ends with remarks on the likelihood of Third Countries retaliation in the different scenarios corresponding to the policy options discussed in the Commission's impact assessment on ruling access of Third Countries' companies to EU PPM.

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Contents

Executive summary

This paper aims to contribute to the discussion on the reasons for the possible difficulties in reciprocating open PPM, between the EU and third countries (TCs), and related policy measures the EU could adopt to enhance openness. It does so focusing on some main strategic themes underlying the EU and TCs interaction in PPM. Within a very stylised game theory framework, a main message of the paper suggests that, under appropriate conditions, open PPM may be more likely when, in the parties' negotiations, the perspective of contracting authorities prevails on that of the business firms[46]. Indeed, the framework seems to point out that when a business firms-related perspective prevails there may be an intrinsic strategic difficulty in opening PPM, that could lead to their closure, or protection. We then discuss that from a business firms' point of view open PPM could be enhanced when complete reciprocation has value *per se*, for both the EU and TCs. Such value may originate from mutual economic, relational, advantages coming from other areas of collaborations.

Moreover, we argue that reciprocated open PPM can be the case when both the EU and a TC entertain different, favourable, views on the associated advantages.

Then we discuss how a dynamic perspective can enhance reciprocated open PPM. As an illustration we consider two examples where advantages are cyclical over time, and parties exhibit different attitudes towards future benefits and losses.

The final chapter focuses on the possibility of retaliation by TCs. Indeed TC retaliation could be a possible reaction to the new legal framework, enacted by the EU to strengthen its position in negotiations and, possibly, enhance reciprocated open PPM. Retaliation may take place also in areas other than public procurement, and could be a risk if the new EU legal framework would restrict access to non-EU companies in non-committed PPM. In particular, as for the question posed by the European Parliament Committee on International Trade

> *"Taking into account game-theory - what assumptions can be made about the risk of retaliation for each of the proposed options and possibilities to create leverage for negotiations through this instrument?"*

[46] By this we mean that negotiations concerning PPM could be conducted by the EU with different goals in mind. In particular, the EU may try to set up agreements with TCs that could be more favourable to its business companies or, alternatively, more favourable to its contracting authorities. In this sense the EU may take different perspectives when negotiating. Indeed, consistently with the outcome of the EC public consultation, such perspectives may differ since firms would typically be more interested in the monetary values of the procurement contracts they could execute, as these would affect their revenues and profits, while contracting authorities may privilege savings and best value for money, to increase their efficiency.

if in negotiations parties would privilege their own business firms' interests, rather than the contracting authorities', the game theory analysis of the paper seems to suggest the following general observation, contained also in the EC impact assessment. Considering the risk of retaliation by TCs *only in terms of further protection* of their PPM, this is higher the lower the leverage of EU. Moreover the analysis appears to suggest that if the new EU legal framework would allow to restrict access by non-EU firms it is plausible that TC would indeed react, either by opening its non-committed PPM or retaliating and further protecting it.

However, since TC reactions may take place in areas other than public procurement, proper estimates of the overall risk of retaliation should consider broader scenarios than just PPM.

Chapter 1 - Reciprocal access in EU and third countries PPM

I - Background

Public procurement contracts-markets (PPC-M) for goods, services and works, count for about 16%-18% of countries' GDP, a truly large share of national incomes. Therefore, access to such markets is extremely important for business companies throughout the world. With the 2004/17/EC and 2004/18/EC public procurement Directives the European Community harmonised national legislations and rules across EU countries, creating a single market for the EU business companies, as well as for non-EU firms interested in accessing public contracts in Europe.

While the EC Directives and GPA agreements generally allow non-EU firms to compete for European public procurement contracts (EC, 2012a), the contrary is not always guaranteed, at least under the same conditions that the EU is granting to non-EU firms in its domestic PPM.

The current asymmetric situation raised an issue within Europe, and the EU is presently concerned about this lack of reciprocated degree of access into third countries PPM. The main preoccupation stems from the negative impact on potential revenues and jobs, that EU companies can suffer when facing difficulties to enter non domestic PPM. Moreover, some non EU-firms, such as for instance few Russian and Chinese companies, may count on state subsidies (aid) (Haley and Haley, 2013) that EU firms obviously cannot rely upon. Therefore, they could be in the position to submit very aggressive price offers, which if not formally considered "abnormally low", and eliminated, can turn out to be unbeatable. Besides un-levelling playing field this could make the problem of asymmetric access even more acute, for appropriate contract execution and delivery, if the state aid would go to rather inefficient firms.

For these reasons the European Commission is now considering the introduction of a legal framework to rule the access of non-EU firms, in the EU public procurement market for goods, services and works. The main goal behind the Commission proposal is twofold. First to strengthen the EU position when negotiating a more open access to EU firms, in third countries PPM, and then to clarify the rules under which TCs companies can compete for EU public procurement contracts (EC, 2012a)

The Commission's impact assessment evaluated the possible impacts of several proposed policy options on how to rule access in the EU public procurement markets by TCs firms.

The European Parliament's Committee on International Trade (INTA) asked for a detailed appraisal of the Commission's impact assessment. One of the themes INTA is interested in exploring is whether a game theory analysis of the strategic interaction, between the EU and third countries, can provide insights on the difficulties for

reciprocated open access in PPM, and on which policy measure the EU may adopt to favor it in the new ruling framework.

The paper takes this point of view developing a simple game theory approach to the issue.

II - Objectives

The main goal of this briefing paper is to set and discuss a stylized non-cooperative game theory analysis to gain broad insights on the difficulties underlying reciprocated open PPM, and on the policy measures the EU can take to induce them. To do so we consider two alternative approaches to negotiations on PPM. One reflecting more a business firms' perspective, interests, while the other more a contracting authorities' point of view, within a static as well as a dynamic framework.

While the static framework should provide insights mostly on the difficulties that parties have in opening their PPM, the dynamic framework could instead provide indications on the possible advantages of reciprocating open markets over time.

Chapter 2 - Some game theory issues under alternative perspectives

Key findings

- Strategic considerations, based on a stylised game theory approach, can illustrate a fundamental difficulty for opening PPM by the EU and TC. Such difficulty, formalised by the fact that closing PPM can be a strictly dominating strategy of the game, for both EU and TC, arises when decisions to open the market are based on the monetary value of the available public procurement contracts. In negotiations this would be a position reflecting more the interest of business firms than the interest of contracting authorities..
- An analogous position, more favorable to business companies than to contracting authorities, would be taken by the EU and TCs if their decisions in negotiations are based on the estimated monetary sums that business firms effectively receive, from the contracting authorities, for the awarded contracts. Also in this case, the same strategic difficulty emerges as closing their domestic PPM could still be a strictly dominating strategy of the game, for both EU and TC
- Taking the point of view of the contracting authorities, aiming to deliver best value for money, as when savings are maximized for given quality level, the strategic scenario might change. The party, either the EU or TC, with the most competitive firms may tend to take advantage of this position to keep its domestic market closed, or more protected, while the other party open. Indeed, the contracting authorities of the party with less efficient firms may find it profitable to allow external firms to enter their own PPM to enhance higher savings.
- Under certain conditions also within a business firms' perspective a dynamic framework, that is a game theory approach where the EU's and TC's future gains and losses are explicitly considered in the model, can favor reciprocated open PPM.
- If open trade is considered to be desirable by the EU, then based on the above considerations our findings seem to suggest that EU policy measures, and negotiation efforts, should try to enhance the value of open domestic PPM, that is to conduct negotiations in order to increase the TCs advantages associated to open PPM, rather than further restricting entry of TCs companies in the EU market.

I – A business firms' point of view

In this section we begin discussing how the difficulty experienced by the EU firms, in receiving reciprocal access to PPM by TCs, can be seen as intrinsic to the underlying structure of the strategic interaction with TCs, when decisions to open or not the internal PPM are based on the monetary value of the announced public procurement contracts. Such perspective on decisions can be seen to reflect more the view of the EU and TC business companies, interested in the overall value of the available public procurement contracts, as summarized by the following simple, stylized, framework.

Suppose n is the number of public procurement contracts for goods, services and works publicly announced in the EU, in a single year. Moreover, let e be the average value, in euro, of such contracts. Then $E = ne$ is the total value, in euro, of the announced EU public procurement contracts, in a single year.

Similarly, suppose m is the number of public procurement contracts (PPC) for goods, services and works announced by TC in a single year, and let t be their average value in euro. Therefore $T = mt$ would be the total value, in euro, of the PPC announced by TC in a single year. Interpreting E and T in a more restrictive way, as the value of PPC in non-committed sectors, would not meaningfully change the ensuing conclusions.

Before signing an agreement on reciprocal access to PPM, if the two parties' position mostly reflects the interest of their own business companies, then EU and TC may reason according to the following scenario. Let for simplicity, yet with no loss of generality, suppose that each party has only two possible actions: either fully open (O) or completely close (C) its domestic PPM. Of course openness-closure could be partial and concern only certain sectors (see Table 6 below), but the main argument would not change. Openness and closure determines which parties' firms can access the two markets.

Assume, as above, that the decision whether to open the domestic PPM, or keep it closed, is exclusively driven by the total monetary value of publicly announced contracts in one year. Then the following payoff table can provide basic insights on the strategic interaction taking place, and related difficulties to reciprocate open markets.

Assume $0 \leq \tau \leq 1$ to be the share of the n contracts, announced by the EU, that *both* EU and TC think TC companies can be awarded when the EU market is open. Moreover, suppose $0 \leq \varepsilon \leq 1$ to be the share of the m public procurement contracts announced by TC, that *both* EU and TC think can be awarded to EU companies when TC opens its own market. Then, considering the total available public procurement values that could potentially go to EU *vs* TC firms, the game in Table 1 illustrates some early strategic elements for the difficulties behind reciprocated open PPM.

Table 1[47]

		TC	
		O	C
EU	O	$E-\tau E+\varepsilon T;\ T+\tau E-\varepsilon T$	$E-\tau E;\ T+\tau E$
	C	$E+\varepsilon T;\ T-\varepsilon T$	$E;\ T$

If EU and TC both decide to open their PPM then the overall value of public procurement contracts potentially available to EU firms is $E-\tau E+\varepsilon T$

That is, the announced EU contracts value minus the value of those contracts awarded to TC firms in the EU market, plus the value of contracts that EU firms can be awarded in the TC market. Analogously, the value of contracts potentially available to TC firms is $T+\tau E-\varepsilon T$.

However, if the EU decides to open its own PPM while TC keeps it closed then EU firms potentially can only have available $E-\tau E$ euro while TC firms $T+\tau E$ euro. Namely, the value of available contracts for EU firms would be lower than when both parties open their markets, while TC firms will have a higher value of potential contracts available, than when both parties have open markets.

As a consequence, if the EU would be willing to consider opening its domestic PPM then TC may have an incentive not to reciprocate, since in so doing its own companies could exploit a higher value of procurement contracts available. Symmetrically, the same reasoning applies if TC considers opening its own public procurement market; in this case EU would be tempted to close its domestic PPM.

As a result, unless parties commit not to do so, a likely outcome of the interaction could be that both players may tend to close, protect, their own PPM.

Indeed, slightly more formally, in the above game *closing the domestic PPM is a strongly dominating strategy* for both parties, that is a strategy providing a strictly larger benefit than opening the market, regardless of the other party's decision (Osborne and Rubinstein, 1994; Maschler, Solan and Zamir, 2013).

The presence of such strictly dominating strategy signals a strong incentive, reason, for the two parties to try keeping their internal PPM closed, protected, and such strong

[47] **Legenda**. In Table 1, as well as in the following tables, each pair in the cells represents the payoffs of EU and TC, when they choose the corresponding pair of actions (or a pair of strategies, i.e. to open (O) or to close (C) PPM). In each one of the four cells in the table, the left term represents the EU payoff while the right term the TC payoff.

element may explain some of the difficulties experienced by the EU in inducing TCs to open their own markets.
It is interesting to notice that the scheme in Table 1 represents a *constant sum game*, that is a game where in each cell the sum of the payoffs obtained by the parties (players) is always the same and equal to $E+T$, that is the total available value of public procurement contracts.

The framework bears some similarities with the celebrated (non-constant sum) "Prisoner's Dilemma" game. This is a game known for featuring a strictly dominating strategy which predicts an inefficient outcome, that is an outcome where both players obtain payoffs lower than those associated to another possible pair of decisions in the game, which however in a one shot game is not part of the prediction and, more formally, not self-sustaining.

Yet the dominating strategies in Table 1, suggesting the pair (E,T) as a likely outcome, do not provide an inefficient prediction, since being constant sum there is no alternative outcome in the game where both parties obtain at least as high a benefit as the pair (E,T). In particular, the pair of payoffs associated to both parties opening their own PPM, $(E-\tau E+\varepsilon T;\ T+\tau E-\varepsilon T)$ would coincide with $(E,\ T)$ if $\tau E=\varepsilon T$, that is if the value of the EU contracts awarded to TC firms equals the value of the contracts awarded to EU firms in the TC market. In this case parties would be indifferent between reciprocating open or closed PPM.

In general, $E-\tau E+\varepsilon T \neq T+\tau E-\varepsilon T$ and either EU or TC, but not both, would prefer the option of the two PPM being open to the option of both being closed. The party more favourable to completely open PPM is the one whose gain, in the external market, more than compensates losses in its own domestic market. In any case, because closure of the internal market remains a dominant strategy, even the party obtaining a higher benefit than the value of internal contracts may still have an incentive to close its domestic PPM if the other is considering keeping its own open. Later, in Chapter 3, we shall argue how the size of τE relative to εT could be seen as an indicator of the parties' leverage in negotiations concerning PPM.

In particular, the current situation of the EU (EC, 2012a) with respect to some major third countries would seem to be broadly illustrated by the top right box of Table 1, the one in which EU is open and TC closed. Lack of reciprocation would make EU to lose εT euro and TC to gain τE euro, with respect to when both markets are open. Consistently with the above prediction, the EU is now also considering (threatening TC) to rule, restrict, access to its domestic PPM.

If we interpret the EC proposal as an effort to induce TC to open its PPM, such *threat* could be credible since in Table 1 scenario EU would indeed increase its payoff. However, if the final goal of the EC proposal is not really to close the own PPM but rather to induce TC to open its domestic PPM then, as we shall argue in Chapter 3, the proposal

may succeed if $T + \tau E - \varepsilon T > T$ that is if $\tau E > \varepsilon T$, namely if EU has a higher leverage than TC.

To summarise dominance of closure, protection, of internal PPM could be seen as a strong element behind some parties' reluctance to open their own markets. Therefore, payoffs and/or approach to negotiations may have to change for parties to open their own domestic PPM. In particular, the fact that the EU has typically advocated the principle of *open markets* can be seen as a change in the above strategic, purely payoff-based, approach. Indeed, the adoption of such principle would make it more difficult for the EU to choose to close its own PPM. This point will be further developed in Chapter 3 when discussing the risk of retaliation.

II –An alternative business firms' perspective

In this section we still consider a business firms' perspective, however from the point of view of the monetary amount that companies effectively receive from contracting authorities, for the awarded contracts. To do so let now p_e and p_t be the estimated average price with which, respectively, EU companies and TC firms win a competition-negotiation for a public procurement contract, in both domestic and external PPM. Hence in deciding whether and which public procurement market sectors to open, an alternative business firms' perspective could be described by the following Table 2

Table 2

		TC	
		O	**C**
EU	**O**	$\varepsilon m p_e + (1-\tau) n p_e ; (1-\varepsilon) m p_t + \tau n p_t$	$(1-\tau) n p_e ; m p_t + \tau n p_t$
	C	$\varepsilon m p_e + n p_e ; (1-\varepsilon) m p_t$	$n p_e ; m p_t$

Although, unlike Table 1, the above game is not constant sum, the decision to close the domestic market, for both parties, remains a strictly dominating strategy. Yet, the predicted pair of payoffs $(np_e; mp_t)$ is still efficient as in Table 1. Indeed, the only possibility for it to be inefficient is that the outcome associated to open PPM, $(\varepsilon m p_e + (1-\tau) n p_e ; (1-\varepsilon) m p_t + \tau n p_t)$, would be component-wise larger than $(np_e; mp_t)$. However, since $\varepsilon m p_e + (1-\tau) n p_e > n p_e$ implies $\varepsilon m > \tau n$ and $(1-\varepsilon) m p_t + \tau n p_t > m p_t$ entails the contrary, $\varepsilon m < \tau n$, this cannot be.

III –A different business firms' perspective

The strategic scenario depicted in Table 1 is based on the assumption that *both*, EU and TC, share the same view on the firms' likelihood of success in PPM. Still within a business firms' perspective, an alternative scenario that we may consider before agreements are finalized is where EU and TC have different views, on the likelihood with

which business firms are awarded public procurement contracts. In particular, suppose τ_e and ε_e indicate the EU's view, estimate, on the share of EU and TC public procurement contracts that, respectively, EU and TC firms can obtain. Then, from the EU perspective the game in Table 1 would now be

Table 3a

		TC	
		O	C
EU	O	$E-\tau_e E+\varepsilon_e T;\ T+\tau_e E-\varepsilon_e T$	$E-\tau_e E;\ T+\tau_e E$
	C	$E+\varepsilon_e T;\ T-\varepsilon_e T$	$E;\ T$

Similarly, if τ_t and ε_t instead represent the TC estimates of the same shares, from its perspective the game in Table 1 would become

Table 3b

		TC	
		O	C
EU	O	$E-\tau_t E+\varepsilon_t T;\ T+\tau_t E-\varepsilon_t T$	$E-\tau_t E;\ T+\tau_t E$
	C	$E+\varepsilon_t T;\ T-\varepsilon_t T$	$E;\ T$

That is, EU and TC may think of playing a different game. Alternatively, it is *as if* EU and TC would believe to face the following (Prisoner's Dilemma-like) game

Table 3c

		TC	
		O	C
EU	O	$E-\tau_e E+\varepsilon_e T;\ T+\tau_t E-\varepsilon_t T$	$E-\tau_e E;\ T+\tau_t E$
	C	$E+\varepsilon_e T;\ T-\varepsilon_t T$	$E;\ T$

Therefore, if conditions

$$E-\tau_e E+\varepsilon_e T>E$$

and

$$T+\tau_t E-\varepsilon_t T>T$$

that is

$$\varepsilon_t T<\tau_t E$$

and

$$\varepsilon_e T>\tau_e E$$

hold then reciprocated open markets might be more likely to emerge.

Indeed, although also in this case closing one's internal PPM remains a strictly dominant strategy for both parties, EU and TC would think that opening their domestic markets induces higher benefits than closing them. This could occur when each party believes that its own business firms sector is relatively more competitive than the other party's.

Although the main prediction (temptation), that EU and TC would tend to close their PPM, remains, they may now have an incentive to commit entering into a formal agreement to open their PPM since, fearing that the final outcome could be closing both markets, they may perceive it as mutually beneficial to formalize a cooperative relation on opening their PPM. As we briefly elaborate also in Section VI below, such conclusion could be further reinforced when advantages coming from future interactions are explicitly taken into account.

IV –A contracting authorities' perspective

In deciding whether, and which, public procurement market sectors to open, the preferences (interests) and views of the EU and TC contracting authorities may differ from those of the internal business sector, as the EC public consultation seems to confirm. Indeed, consider now Table 4 below where the payoffs are represented by the estimated savings, for the desired quality level, of the two parties' contracting authorities. It is important to point out that the analysis is conducted assuming that the desired quality is effectively delivered by the suppliers. Alternatively, different considerations should be contemplated.

Table 4

		TC	
		O	C
EU	O	$E-\tau np_t-(1-\tau)np_t;\ T-\varepsilon mp_t-(1-\varepsilon)mp_t$	$E-\tau np_t-(1-\tau)np_t;\ T-mp_t$
	C	$E-np_t;\ T-\varepsilon mp_t-(1-\varepsilon)mp_t$	$E-np_t;\ T-mp_t$

It is easy to see that $p_e > p_t$ would lead to the top right corner pair of payoffs $(E-\tau np_t-(1-\tau)mp_e;\ T-mp_t)$ as a plausible (Nash Equilibrium)[48] predicted outcome, while $p_e < p_t$ to the bottom left corner (Nash Equilibrium) prediction $(E-np_e;\ T-\varepsilon mp_e-(1-\varepsilon)mp_t)$.

[48] A Nash Equilibrium is defined as a pair of strategies such that each component of the pair is optimal, payoff maximised, against the other component. For example, if $p_e > p_t$ the pair of strategies (O,C) is a Nash Equilibrium of the game because in this case O for EU is optimal when TC chooses C, as well as C for TC is optimal when EU chooses O (Osborne & Rubinstein, 1994; Maschler, Solan & Zamir, 2013)

Indeed when $p_e > p_t$, namely TC firms are more efficient than EU firms, then opening its domestic PPM becomes a strictly dominant strategy for EU, while closing its own PPM is dominant for TC. Analogously $p_e < p_t$, that is EU companies are more efficient than TC ones, would make closing the PPM dominant for EU and opening the PPM dominant for TC.

That is, if the savings maximisation perspective of the own contracting authorities prevails in negotiations this could change the outcome of the strategic interaction. Indeed public administrations may be interested in having their domestic market open to outside firms, even if the counterpart does not reciprocate, when external companies are more efficient than domestic firms, that is they could deliver the same or better quality at lower prices.

As a consequence, the party with more efficient firms would be in a *stronger strategic position,* possibly inducing the other party to tolerate lack of reciprocation in open markets, just because companies from outside deliver better value for money. Hence, the prediction would suggest that the *stronger* party may tend to keep a more protected domestic PPM while the other, weaker, party a more open one. To summarise, a contracting authority perspective in negotiations seems to favor (at least partial) PPM opening more than a business firms point of view.

V –The value of reciprocated open PPM

Consider again the initial scenario, of Section I, where now full reciprocation of open PPM has a "value". We introduce such value in the scheme simply *via* its monetary equivalent r_E and r_T, respectively for EU and TC, on the top left corner of Table 1, as in Table 5.

Table 5

		TC	
		O	C
EU	O	$E-\tau E+\varepsilon T+r_E;\ T+\tau E-\varepsilon T+r_T$	$E-\tau E;\ T+\tau E$
	C	$E+\varepsilon T;\ T-\varepsilon T$	$E;\ T$

The values r_E and r_T may be due to gains from cooperation, between EU and TC, in areas other than public procurement, and materialize only if "both parties reciprocate open PPM".

Then, for EU, closing its domestic public procurement markets would cease being a strictly dominating strategy if

$$E-\tau E+\varepsilon T+r_E > E+\varepsilon T$$

that is if

$$r_E > \tau E \qquad (1)$$

namely if the value of reciprocation for EU more than counterbalances the value of EU procurement contracts, potentially awarded to TC firms. Similarly, from the perspective of TC, closing the PPM would cease being a strictly dominating strategy if

$$r_T > \varepsilon T \qquad (2)$$

i.e. if the value of complete reciprocation for TC is larger than the value of the contracts awarded in the TC market, to EU companies.

If both (1) and (2) are satisfied then the strategic scenario of Table 4 would change with respect to Table 1. Indeed, now the two pairs (O,O) and (C,C) would both be possible predictions (Nash Equilibria) of the game.

Therefore unlike the scenario of Table 1, where closing the internal markets is a dominating option, EU and TC would now have the opportunity to decide whether to open or close its own domestic PPM, depending upon the "attitude" of the opponent. This occurs because r_E and r_T would typically transform the strategic interaction of Table 1 in a *non-constant sum game*.

The presence of two possible predicted outcomes (Nash Equilibrium), and the absence of a dominating strategy may introduce uncertainty on which pair of decisions EU and TC could eventually take.

More formally, considering Table 5, as far as EU is concerned, a way to quantify such uncertainty could be with reference to the so-called Mixed Strategy Nash Equilibrium (Osborne & Rubinstein, 1994; Maschler, Solan & Zamir, 2013), defined as the probability $p = p^*$ solving the following equality between the expected benefit of opening or closing its domestic PPM to TC

$$p^*(E - \tau E + \varepsilon T + r_E) + (1 - p^*)(E - \tau E) = p^*(E + \varepsilon T) + (1 - p^*)E$$

leading to

$$p^* = \frac{\tau E}{r_E} \qquad (3)$$

which, being $r_E > \tau E$, is less than one and so a proper probability expression.

More explicitly, if EU thinks that in negotiations TC could open its domestic PPM with probability $p = p^*$, then EU would be indifferent between opening or closing the market,

since both decisions provide the same expected benefit. In particular, replacing p^* into the expected profit expression it follows that such common expected benefit is equal to

$$\frac{\tau E}{r_E}(E+\varepsilon T)+\left(1-\frac{\tau E}{r_E}\right)E=E+\frac{\tau E}{r_E}\varepsilon I$$

hence, obviously, higher than the value E of the EU public procurement contracts. As a consequence, if EU believes that TC may accept opening its internal PPM with probability $p>p^*$then it would be optimal for EU to conduct the negotiations for opening its own internal PPM. However, if EU thinks that TC may opt with a relatively low probability, $p<p^*$, for opening its domestic PPM then it may prefer to keep it protected

An interpretation of the above findings could be as follows. The closer τE is to r_E, the more EU must believe that TC is willing to open the domestic PPM, in order to conduct the negotiations towards opening its own PPM. Indeed, in this case its advantage from reciprocal opening tends to be counterbalanced by the value of EU contracts awarded to TC firms.

Following a similar reasoning for TC, $q=q^*$ would be the probability equalizing the expected benefit of opening and closing its domestic PPM to EU firms, solving the equation

$$q^*(T+\tau E-\varepsilon T+r_T)+(1-q^*)(T-\varepsilon T)=q^*(T+\tau E)+(1-q^*)T$$

leading to

$$q^*=\frac{\varepsilon T}{r_T} \qquad (4)$$

which, since $\varepsilon T<r_T$, represents a proper probability expression.

Analogously, if TC believes that EU may accept opening its internal PPM with probability $q>q^*$ then it would be optimal for TC to open its own internal PPM. However, if TC thinks that EU may opt with probability $q<q^*$ for opening the domestic PPM then it would prefer to close its own PPM.

Therefore, the closer εT is to r_T the more TC must believe that EU is willing to open the domestic PPM, in order to drive the negotiations towards opening its internal PPM. Again, as well as for the EU above, this is because the advantage of reciprocating open PPM tends to be counterbalanced by the value of the contracts awarded to EU companies.

To summarise this section, efforts and negotiations to foster the advantages, the value, of reciprocal PPM opening can have an important strategic role in enhancing it.

VI –A business firms' point of view in a dynamic context.

The discussion in previous sections appear to suggest that reciprocating open PPM could be more difficult when negotiations are mostly affected by the business sector interests. Such difficulty was illustrated within a static game theory approach, that is from a perspective in which EU and TC were not explicitly taking into account benefits and losses of future interactions.

In this section we consider such dynamic framework to briefly discuss if, and under what circumstances, it could affect decisions. In particular, to illustrate the point we shall present two examples to see how a dynamic perspective could modify the conclusions of Section I, and reinforce those of Section III.

Start considering a very simple modification of the scenario in Section I, supposing that *both* EU and TC think that Table 1 rather than being constant could vary over time. In particular, still to keep things extremely simple, for the sake of illustration imagine that Table 1 changes periodically over two consecutive years, $y = 0, 2, 4, ..$ (even) and $y + 1 = 1, 3, 5, ..$ (odd), for example, according to the following pattern

Table 6a
Year y (even)

		TC	
		O	C
EU	O	$E - \tau_y E + \varepsilon_y T;\ T + \tau_y E - \varepsilon_y T$	$E - \tau_y E;\ T + \tau_y E$
	C	$E + \varepsilon_y T;\ T - \varepsilon_y T$	$E;\ T$

with

$$\tau_y E < \varepsilon_y T$$

and

Table 6b
Year $y + 1$ (odd)

		TC	
		O	C
EU	O	$E - \tau_{y+1} E + \varepsilon_{y+1} T;\ T + \tau_{y+1} E - \varepsilon_{y+1} T$	$E - \tau_{y+1} E;\ T + \tau_{y+1} E$
	C	$E + \varepsilon_{y+1} T;\ T - \varepsilon_{y+1} T$	$E;\ T$

with
$\tau_{y+1}E > \varepsilon_{y+1}T$

That is, EU and TC think that reciprocating open PPM brings advantages, over reciprocated closure, in alternating years. In particular, EU will have an advantage in even years while TC in odd years.

Suppose $0 < \delta < 1$ and $0 < \theta < 1$ is the discounting factor of, respectively, EU and TC. That is the weight which multiplied by a payoff available next year gives the current value of that payoff.

Then, by defining $\varepsilon_y T - \tau_y E = a > 0$ and $\tau_{y+1}E - \varepsilon_{y+1}T = b > 0$ it is immediate to see that EU will find it convenient to sign at time $y = 0$ an agreement reciprocating open PPM (rather than reciprocating closed PPM), valid for all years $y = 0, 1, 2, 3, \ldots$, if

$$(E + a) + \delta(E - b) + \delta^2(E + a) + \delta^3(E - b) + \cdots > E + \delta E + \delta^2 E + \cdots$$

that is if

$$\frac{(E + a) + \delta(E - b)}{(1 - \delta^2)} > \frac{E}{(1 - \delta)}$$

namely if

$$\delta < \frac{a}{b} \qquad (5)$$

hence if EU has a relatively low discount rate, or alternatively if it is sufficiently impatient.

Analogously, TC would find it convenient to sign a reciprocating agreement with EU for opening PPM if

$$(T - a) + \theta(T + b) + \theta^2(T - a) + \theta^3(T + b) + \cdots > T + \theta T + \theta^2 T + \cdots$$

hence if

$$\frac{(T - a) + \theta(T + b)}{(1 - \theta^2)} > \frac{T}{(1 - \theta)}$$

entailing

$$\theta > \frac{a}{b} \qquad (6)$$

that is if TC is sufficiently patient.

The two conditions, (4) and (5), can both be satisfied only if $a < b$, that is when the gains of the EU, which in our simple example is the party that will first enjoy a benefit after the agreement is initially signed at $y = 0$, are lower than those of TC which will start to gain later.

Therefore, to summarise, consistently with the intuition the agreement on reciprocating open PPMs could take place if the more impatient party will gain sooner, though less than the other party, losing later, while the more patient party will start losing and then gain later, however enjoying a higher benefit than the other party.

A policy indication emerging from the example is that a different attitude, by the two parties, towards future gains and losses may be a driver to facilitate the implementation of a reciprocating agreement to open their domestic PPMs.

Analogous conclusions could follow considering now Section III, where we discussed the possibility that different views by the EU and TC on the benefits obtained when both PPM are open can transform the game in Table 1, with equal views, in a Prisoner's Dilemma type-of-situation of Table 3c. That is, in a game where closing the market is still a dominant decision for both parties, however now inefficient. In Section III we argued that this change may induce EU and TC to enter into a formal agreement for reciprocating open markets. Such decision could actually be reinforced taking a dynamic perspective. Indeed, in this case the short run advantages from entering into such agreement, rather than keeping PPM closed, would increase with the possibility of enjoying the benefits for a sufficiently long period of time.

In a similar, though not completely the same, spirit as a second example consider again the original formulation of Table 1, to discuss the possibility that each party will not open its domestic PPM every year, but rather in alternating years.

Table 1

		TC	
		O	C
EU	O	$E-\tau E+\varepsilon T;\ T+\tau E-\varepsilon T$	$E-\tau E;\ T+\tau E$
	C	$E+\varepsilon T;\ T-\varepsilon T$	$E;\ T$

More specifically, suppose that EU and TC consider the following formal agreement. In even years $y = 0, 2, 4, ..$ EU will have its market closed and TC open while in odd years $y = 1, 3, 5, ...$ EU will open its PPM and TC will close it. Hence, the EU will prefer to formally enter into such an agreement (rather than reciprocating closed PPM) if

$$(E+\varepsilon T)+\delta(E-\tau E)+\delta^2(E+\varepsilon T)+\delta^3(E-\tau E)+\cdots.>E+\delta E+\delta^2 E+...$$

from which, as in (5) with $a=\varepsilon T$ and $b=\tau E$, it follows that

$$\delta<\frac{\varepsilon T}{\tau E} \qquad (7)$$

Analogously, TC will prefer entering into the agreement if

$$(T-\varepsilon T)+\theta(T+\tau E)+\theta^2(T-\varepsilon T)+\theta^3(T+\tau E)+\cdots.>\theta+\theta T+\theta^2 T+...$$

hence, as in (6), if

$$\theta>\frac{\varepsilon T}{\tau E} \qquad (8)$$

In this case, a necessary condition for (7) and (8) to hold is that $\varepsilon T<\tau E$, that is if the value of contracts potentially obtainable by EU firms in the TC public procurement market is lower than the value of contracts potentially awarded to TC companies in the EU market. In the next Chapter we shall see a nice interpretation, in terms of EU leverage, of the ratio $\frac{\varepsilon T}{\tau E}$.

Chapter 3 - Retaliation risk

Based on the above analysis, and the EC impact assessment, with this chapter we conclude the paper discussing one of the issues specifically addressed in the question from the European Parliament's INTA Committee: the possibility that the application of the new instrument proposed for regulating the access of TC to its PPM may trigger forms of retaliation by TC.

Estimating the risk of retaliation is not an easy task, whether it refers to the probability of retaliation and/or the size of retaliation. Furthermore, retaliation can take place in areas other than PPM.

Borrowing from insights in Section V of the previous chapter, and consistently with the EC impact assessment based on leverage, it appears that the likelihood of retaliation should concern the economic advantages and disadvantages associated to the policy option that the EU will choose to adopt.

Therefore, a fundamental preliminary step to discuss this point are the gains and losses that EU and TC can have as a consequence of the new regulatory measure. Although EU is considering ruling the access of TC firms, because of an existing disadvantageous asymmetry, some EU firms already access the TC public procurement markets and may suffer economic losses in case of retaliation.

Further elaborating the Tables in the previous chapter, it is possible to consider explicitly the three potential scenarios of retaliation, depicted by the EC

> "(a) No retaliation - none of the trading partners takes measures restricting exports of EU goods and services to their procurement market.
> (b) Simple retaliation - the trading partners that have not enacted crosscutting retaliatory measures (like India and Australia) introduce such measures and Turkey reinforces its existing measures on the same scale as the EU.
> (c) Boycott (or 'massive retaliation') - trading partners completely close their PP open domestically but not committed internationally, to "boycott" EU goods and services." (EC, 2012a, chapter 6.3.2, page 29)

In particular, below we articulate Table 1 to include the third option of *regulation*. Hence the three actions, $O(\text{pen}), R(\text{egulate})$ and $C(\text{lose})$ appearing in Table 6, where $\mathbf{0} \leq \tau_R \leq \tau$ and $\mathbf{0} \leq \varepsilon_R \leq \varepsilon$ are the shares of available contracts in case EU and TC regulate the access to their domestic PPM, an intermediate situation between completely open and fully close PPM, can be seen to represent the above scenarios (a), (b) and (c).

Table 6

		TC		
		O	R	C
EU	O	$E-\tau E+\varepsilon T;\ T+\tau E-\varepsilon T$	$E-\tau E+\varepsilon_R T;\ T+\tau E-\varepsilon_R T$	$E-\tau E;\ T+\tau E$
	R	$E-\tau_R E+\varepsilon T;\ T+\tau_R E-\varepsilon T$	$E-\tau_R E+\varepsilon_R T;\ T+\tau_R E-\varepsilon_R T$	$E-\tau_R E;\ T+\tau_R E$
	C	$E+\varepsilon T;\ T-\varepsilon T$	$E+\varepsilon_R T;\ T-\varepsilon_R T$	$E;\ T$

It is immediate to check that even in this more articulated scenario the dominant decision, by both parties, would still be to close PPM. Yet, in Table 6 it may be easier to argue on the possibility of retaliation. Indeed, retaliation can be a credible, real, possibility when its advantages more than compensate disadvantages. Hence if the current, asymmetric, situation could be represented by EU being fully open and choosing O, with TC being partly protected and choosing R, then if EU should decide to regulate it would still be a strong temptation for TC to close completely and retaliate, however as well as it would have been if the EU domestic PPM was open, just because closing the domestic PPM is a dominant option.

As a consequence, the risk of retaliation of TC given by the EU restricted access to TC firms, could be meaningful if Table 6 is a good representation of the current scenario. Indeed in this case once the policy option R is enacted by EU, retaliating, that is increasing protection of the domestic PPM, has no losses but only advantages. Any position, different from complete closure by both parties, could be in principle a very fragile equilibrium and susceptible to retaliation at any time.

Therefore, the risk of retaliation can be mitigated in scenarios other than Sections I and II of Chapter 2. In particular by extending considerations stemming from expressions (3) and (4) in Section V. Indeed, that simpler scenario suggests that the risk of retaliation can be lower if the value that parties obtain, by reciprocating open PPM, is sufficiently higher than what internal firms can potentially lose by opening their domestic markets.

This is overall consistent with the impact assessment methodology and the outcome of the EC public consultation. That is in negotiations with TC the EU leverage is very important. More specifically, in the impact assessment the EU leverage is defined as the ratio l_E between the percentage of potentially unfulfilled exports of TC companies in the EU procurement market over the percentage of potentially unfulfilled exports of EU firms in the TC market (EC, 2012a).

Strictly within the stylised set up of Table 1, where for simplicity we introduced no distinction between committed and non-committed PPM, such ratio would correspond to

$l_E = \frac{\tau E}{\varepsilon T}$. If $l_E > 1$ then we could say that EU has higher leverage than TC, and the opposite if $l_E < 1$.

Therefore if in Table 1 the current, initial, position before negotiations is with EU open and TC closed, (O,C), then if $l_E > 1$ under the EU's threat to close the market TC would rather prefer the position (O,O) to (C,C). Indeed, with fully open markets the TC payoff $T + \tau E - \varepsilon T$ would be larger than its payoff with fully closed markets T. As for timing, in reality what could occur is that the new EU rule is enacted, and then reciprocated open markets are agreed upon afterwards or else TC may anticipate, before the new rule is approved, that agreeing on (O,O) is more convenient. Thus if TC has higher leverage, $l_E < 1$, then starting from (O,C) it is likely that the final outcome would be (C,C).

The introduction of the leverage ratio l_E provides us with an interesting interpretation of conditions (7) and (8). In fact the former can now be rewritten as

$$\delta < \frac{1}{l_E} \qquad (7')$$

while the latter as

$$\theta > \frac{1}{l_E} \qquad (8')$$

which, if $l_E > 1$, can potentially be both satisfied. Hence, it is *only if* the EU has higher leverage and it is more impatient than TC that the dynamic agreement depicted in Section VI of Chapter 2, where EU is the first to gain, may take place.

In what follows, based on the above considerations, we address some questions specifically raised by the European Parliament's Committee on International Trade on the risk of retaliation (in the following numbered from (a) to (d)).

(a) "Is there evidence of the Commission's assumption that the more an option limits access to foreign goods and services the higher the risk of retaliation is?"

Clearly such evidence cannot be provided by EU public procurement markets as the proposal for ruling access of TC's firms is a new initiative. Therefore, empirical evidence should, in case, be extracted from past trade agreements. Yet Table 6 can provide some insights on the likelihood of TC retaliation, in case EU regulates access into its PPM. In what follows the analysis of retaliation will be conducted *strictly* within the scenario of Table 6, hence excluding areas other than PPM.

Indeed, if currently EU is open and TC is regulated, that is the initial position before EU would regulate access of TC firms is the pair of strategies (O,R), then TC's payoff is $T + \tau E - \varepsilon_R T$. Suppose that in order to enhance reciprocated open markets EU considers

to regulate access to its domestic PPM, moving to the position (R,R). Then retaliation by TC, that is movement to (R,C) may be undesirable for TC if its payoff in the (O,O) position is higher than what it could obtain in the (R,C) position.

More explicitly, if $T+\tau E-\varepsilon T>T+\tau_R E$ hence

$$\frac{(\tau-\tau_R)E}{\varepsilon T}>1 \qquad (9)$$

that is, if the share τ_R of EU contracts potentially available to TC firms, when EU regulates access to its PPM and TC retaliates (closes), is sufficiently low. From the above consideration it also follows that a necessary, though not sufficient, condition to prevent retaliation is that $\frac{E\tau}{\varepsilon T}>1$ namely the EU, *globally*, has higher leverage than TC. Obviously, if (9) is satisfied then TC would also prefer position (O,O) to position (R,R). Indeed, for this to occur it must be $T+\tau E-\varepsilon T>T+\tau_R E-\varepsilon_R T$ and so

$$\frac{(\tau-\tau_R)E}{(\varepsilon-\varepsilon_R)T}>1 \qquad (10)$$

But since $\frac{(\tau-\tau_R)E}{(\varepsilon-\varepsilon_R)T}>\frac{(\tau-\tau_R)E}{\varepsilon T}$ then if (9) holds also (10) does.

To summarise, again assuming Table 6 to be a reasonable description of the current situation, when EU regulates access to its domestic PPM it is more likely for TC to either retaliate and further protect, or else open, its domestic PPM than not react remaining in the original position

(b) "Is the Commission's estimate of the risk of retaliation consistent and based on evidence and a proper methodology?

As I was arguing above the data and methodology, based on leverage, adopted by the Commission to estimate the risk of retaliation, overall seem consistent and proper. If EU's leverage is perceived as being too low, because of the (already taken) EU position advocating open markets, then a way for increasing it could be as suggested in Section V of the previous chapter. That is to enhance the value of open PPM by referring to areas other than public procurement, such as lowering trade barriers conditional upon opening PPM etc.

(c) "Has the potential of leverage for market opening in third countries being properly assessed? "

Overall I think the definition of leverage proposed by the EC is a satisfactory indicator to quantify the EU negotiation strength. Indeed it is a good measure for embodying gains and losses related to the proposed regulation framework.

Yet, perhaps, we could make the following observation. Let $\tau E=\tau_C E+\tau_{NC}E$ where τ_C and τ_{NC} are, respectively, the estimated share of EU contracts that TC firms obtain in, respectively, committed and non-committed PPM sectors. Similarly let $\varepsilon T=\varepsilon_C T+\varepsilon_{NC}T$

where τ_C and τ_{NC} are, respectively, the estimated shares of TC contracts that EU firms obtain in, respectively, committed and non -committed PPM sectors. Then, formally, the EU leverage indicator proposed by EC is

$$\frac{\tau_{NC}E}{\tau E} / \frac{\varepsilon_{NC}T}{\varepsilon T}$$

that is a ratio of %. Therefore since such ratio is not based on absolute values, but on proportions, it could not convey information on the size of the non-committed sectors for the two parties. For example, suppose $\frac{\tau_{NC}E}{\tau E} = \frac{1bln€}{1bln€} = 1$ and $\frac{\varepsilon_{NC}T}{\varepsilon T} = \frac{1mln€}{1mln€} = 1$. Here the EU indicator for leverage would be 1, meaning that EU and TC have the same leverage. However, while the absolute value of non-committed contracts in EU could be in the order of $1bln€$, in TC it could be much lower, e.g. in the order of $1mln€$. Can we claim that despite this massive difference EU and TC have the same leverage? Perhaps it would be tempting to say that EU has much higher leverage, since the potential non-committed market that TC firms can reach is much larger than what EU could obtain. An indicator of the type considered above $\frac{\tau_{NC}E}{\varepsilon_{NC}T}$ could take this difference into a better account. To summarise, although the leverage indicator adopted in the impact assessment is a satisfactory measure, it may fail to properly capture meaningful discrepancies in the absolute value of non-committed markets, which could signal an important difference in the leverage of the two parties.

(d) "Taking into account game-theory - what assumptions can be made about the risk of retaliation for each of the proposed options and possibilities to create leverage for negotiations through this instrument? "

As already discussed until now, for each of the proposed options the above game theory analysis seems to suggest the following general principle. The risk of retaliation of TC is higher the lower the leverage of EU, where the leverage may vary depending upon the initial, current, payoff of TC and its final payoff, after EU regulated access is enacted and TC retaliates. Indeed, if this is sufficiently low as compared to what TC firms could obtain by reciprocating open markets, then retaliation may be less likely. Again, this consideration is mostly conditional to retaliation being within PPM.

For a more elaborate discussion of the issue, below we consider some selected policy options in the impact assessment (EC,2012a)

(1) "Baseline scenario: "Nothing happens"" (Option 1)

For obvious reasons, this option should induce the lowest risk of retaliation since no new regulatory measures for access of non-EU firms would be enacted.

(2) "Approach based on an overall access restriction for not covered procurement at the EU level" (Option 3A)

Under this option exclusion by Member States of TC firms from non-committed markets would be somehow systematic, except for emergencies and specific goods-services

unavailable in the EU. Therefore the option may embody a high potential leverage for the EU to induce TC to open its non- committed PPM. Yet, just because of its high potential as a threat, once enacted it may trigger high retaliatory measures as a defensive action if EU leverage is still not high enough, when TC faces the EU decision.

(3) "At the level of MS: individual procuring entities' decisions under the supervision of the European Commission" (Option 3B1)

This would be a milder option than (2) in terms of potentially excluding non-EU firms. As a consequence, it should have a lower leverage as a threat to induce open PPM, but also a lower potential for retaliation.

(4) "At the EU level: the Commission-driven mechanism" (3B2)

A potentially interesting option, since exclusion of non-EU firms would not be automatic but possibly negotiated case by case, leaving the TC with the possibility of opening access to its PPM. Just because of this flexibilility in applying restricted access, in principle the option should not induce higher retaliation than options (3A) and (3B1)

(5) " Option for contracting entities to accept companies, goods and services not covered by the EU's international commitments, subject to notification of the Commission and Commission option to impose access to the EU's public procurement market" (Option 3C)

This option bears some similarities with (4) however with a meaningful distinction. That is, the EU would take a final decision on accepting a non-EU company, provided substantial reciprocity with the TC is granted. Therefore, with respect to (4) the possibility to negotiate before, possibly, excluding a TC firm would not seem to be possible. Because of this, in principle the option would appear to have a higher retaliation potential than (4)

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