



## Public Procurement: How open is the European Union to US firms and beyond?

Lucian Cernat and Zornitsa Kutlina-Dimitrova

### Key Points

A recent report on public procurement published by the United States Government Accounting Office (GAO) attempted to provide a range of estimates for the EU and the US, among others, and argued that the EU awarded a low share of public procurement contracts to US firms (\$300 million) compared to a much higher value of US public procurement (\$3 billion) awarded to EU firms (GAO 2019). However, the methodological approach used by GAO was partial and misrepresented the level of EU openness, as it only looked only at the 'tip of the procurement iceberg' and missed out other main avenues for international government procurement. Once these other two main procurement modes are taken into account, EU openness in procurement is much higher, vis-a-vis both for US and third countries. Overall, the EU has awarded over €50 billion worth of public contracts to foreign firms, out of which €11 billion to US firms. Comparable data across all modalities do not yet exist for the US, but we do have clear evidence that, since 2009, the US has introduced the largest number of protectionist procurement measures severely affecting international procurement.

Against this background, this Policy Brief makes four basic points:

- i. Public procurement is a key area of trade negotiations, and the EU remains committed to promoting further non-discriminatory access to procurement markets both at home and abroad.
- ii. The existing levels of openness in procurement markets need to be assessed across all three procurement modalities and not only on direct cross-border procurement, which is not the main procurement avenue. According to a comprehensive approach, such as the one used in this brief, the EU market already has a high foreign penetration rate, including by US companies.
- iii. Unfortunately, similar procurement data (at both federal and sub-federal level) does not exist for the US market. But there is growing evidence of discriminatory measures introduced in recent years, which impede the ability of EU and other foreign firms to compete on a level-playing field in US procurement markets.
- iv. The importance of procurement as a key negotiating area requires better data and a greater analytical engagement internationally.

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## International Government Procurement: Raising the stakes high

Government procurement accounts for a two-digit share of GDP in developed economies. In the EU alone it amounts to 13% of GDP net of public procurement of State-Owned Enterprises (SOEs) (Kutlina-Dimitrova, 2018). Government procurement is also gaining in importance at the WTO and in bilateral free trade agreements (Cernat & Kutlina-Dimitrova, 2015). At the same time, protectionism in this field has been progressively on the rise with the number of discriminatory protectionist measures steadily increasing over time (Kutlina-Dimitrova, 2018). This is even more worrying, as recent economic research shows that there are sizeable benefits to be reaped from extending the scope and coverage of the WTO Government Procurement Agreement (GPA) (Kutlina-Dimitrova, 2017) and eliminating “Buy-American” provisions in the US market (Dixon et al., 2017).

Recently a Bloomberg article tried to shed light on the ‘real’ openness of the EU and US public procurement markets (Baschuk, 2020a and 2020b). The articles claim that the US public procurement market is significantly more open to foreign competition than that of its main strategic partners, with the exception of Canada. The author based his views largely on a recent report by the US Government Accountability Office (GAO) on foreign sourcing in government procurement (GAO, 2019).

The Bloomberg article (and the GAO report) state that the US has a huge deficit with the EU in government procurement, as US firms have, allegedly, won contracts worth \$300 million in the EU, whereas EU firms have been awarded public contracts worth almost ten times more in the US. However, the article does not make clear that these figures refer only to direct cross-border procurement (mode 1, see box 1), i.e. US public contracts awarded directly to a foreign company located abroad (see also next section). By looking only at one procurement mode (and not the most important one) the Bloomberg article provides an inaccurate picture of the full EU openness in public procurement.

One of the main purposes of this brief is to provide a comprehensive set of estimates of the extent to which foreign suppliers participate in the EU public procurement markets.

This brief also makes the point that any serious discussion about market openness in government procurement has to include all three modes of supply available to foreign suppliers (see box 1). The contracts won by foreign firms under Mode 1 are only the ‘tip of the iceberg’ and any conclusions drawn solely on Mode 1 procurement data provide a biased and extremely partial view of the real public procurement openness in any country.

*Box 1. International procurement modalities*

**Procurement mode 1 – direct cross-border international procurement:** a foreign company submitting and winning a public contract ‘from abroad’.

**Procurement mode 2 – commercial presence procurement:** a domestic subsidiary of a foreign company wins ‘locally’ a public contract.

**Procurement mode 3 – Value-added indirect international procurement:** a foreign company participates indirectly in a bid by providing intermediate goods and services.

Source: Based on Cernat and Kutlina-Dimitrova, (2015).

## The ‘real’ openness of the EU public procurement market

With a total government procurement market above the GPA thresholds<sup>1</sup> of over €400 billion, if the value of contracts offered by EU public authorities to US firms would be only €300 million, then indeed such a figure would indicate a low level of ‘de facto’ openness.

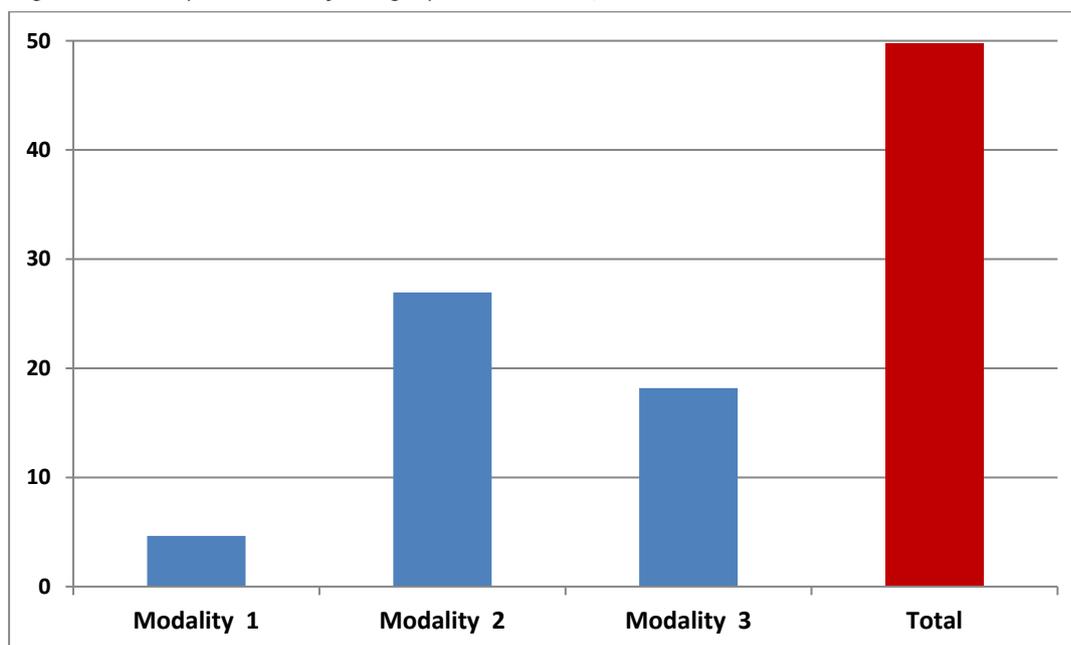
The reality is, however, very different. In the following section, we provide a set of estimates of the ‘real’ openness of the EU government procurement market, based on a combination of publicly available sources. Following the description of modes 1-3 of international procurement depicted in Box 1, Figures 1 and 2 below provide the size of the ‘de facto’ openness of EU member states to foreign providers from the world as a whole (excluding intra-EU) and the US, in particular.

## The total value of foreign participation in EU public procurement

According to the official Tenders Electronic Daily (TED) database, in 2017 foreign firms received contracts worth more than €4.6 billion under mode 1, directly cross-border (see Figure 1). This information is based on the official TED data for that year, subject to a thorough consistency check. The adjustments carried out to the original dataset were minor, reflecting the application of the EU Directive thresholds and manual check-ups for the removal of extreme values.

<sup>1</sup> For all members of the WTO Government Procurement Agreement, public procurement is subject to international disciplines whenever the value of the contract is above a certain value threshold. These thresholds depend on the nature/type of the contract. For more information, see <https://e-gpa.wto.org/en/ThresholdNotification/FrontPage>.

Figure 1. EU openness in foreign procurement, € bn



Source: Own calculations.

In addition to mode 1 contracts, foreign firms received government contracts worth €27 billion via their EU subsidiaries. This value is obtained on the basis of the total above threshold EU procurement market size and the share of mode 2 procurement, which accounts for 20.4% of the total market.

Further adjustments were undertaken to account for the share of extra- versus intra-EU contracts. The underlying figures that are used for these Mode 2 calculations are provided in a report on the measurement of cross-border penetration in public procurement commissioned by the European Commission (VVA consulting et al., 2017).

Our estimates for mode 3 procurement point to around €18 billion worth of goods and services provided by foreign suppliers indirectly to EU public authorities in 2017. This value is obtained by applying the share of procurement awarded indirectly to foreign firms via subcontracting, consortia and wholesales. This share (12%) was estimated through a pan-European firm survey, carried out as part of the Ramboll (2011) report. Our estimate for Mode 3 international procurement discounts the value of intra-EU indirect procurement and reports only the value of foreign (extra-EU) mode 3 procurement.

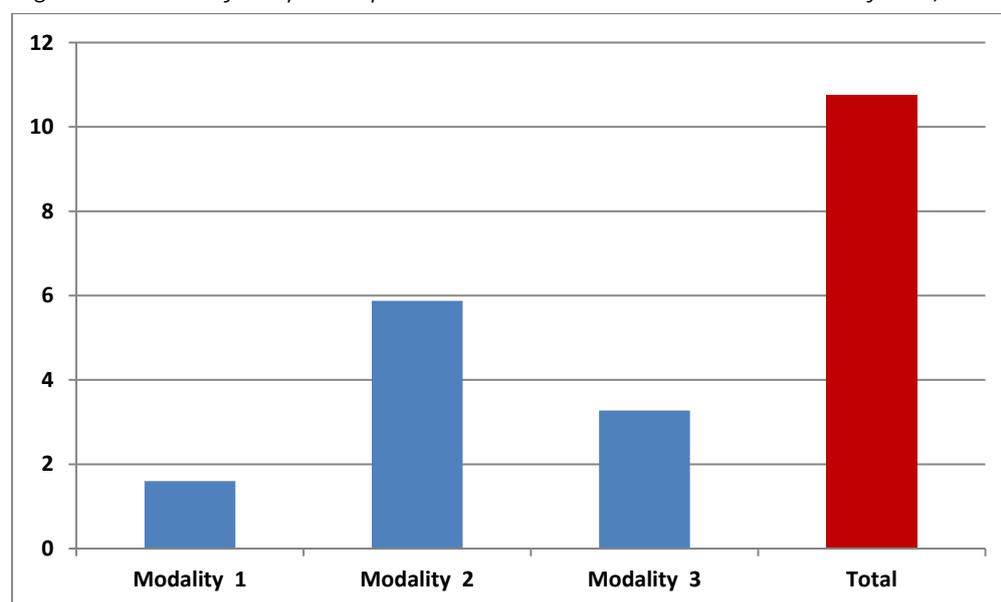
Therefore, as shown in Figure 1, the total value of public contracts awarded by EU public authorities (directly or indirectly) to foreign firms amounts to almost €50 billion. As previously stressed, it is critical to assess the openness in public procurement across all three modes of supply. For example, if only Mode 1 public procurement estimates are used (€4.6 billion), roughly 90% of the 'real' openness of EU public procurement would be neglected.

## The value of EU public procurement awarded to US firms

Following the same methodological approach, we also estimate the value of public procurement won by US firms in the EU (Figure 2). As for the overall procurement openness offered to all foreign firms, the TED database indicates a value for Mode 1 procurement contracts awarded to US firms directly cross-border of more than €1.6 billion in 2017.

The procurement value awarded to US foreign subsidiaries in the EU (Mode 2) is far more important and amounts to nearly €6 billion. We arrived at this amount by applying the US share (22%) in total EU Mode 2 procurement, and discounting for the share of intra-EU foreign subsidiaries contracts (VVA et al., 2017).

Figure 2. Value of EU public procurement contracts awarded to US firms, € bn



Source: Own calculations.

Based on the same estimates by Ramboll (2011) of indirect procurement via subcontracting, consortia and wholesaling, and using the share of US goods and services in extra-EU imports as a proxy for the value of US intermediate inputs, the value of mode 3 procurement for the US amounts to more than €3 billion.

## The actual cost-benefit analysis of opening international procurement markets

The GAO (2019) report has been noticed by many commentators for the alleged ‘procurement deficit’ that the US has with many key trading partners, including the EU. On the basis of this finding, several voices (including in the US administration) considered that the GPA offers little benefit to US firms in procurement markets worldwide and therefore questioned the rationale for continued US GPA membership.

However, as already mentioned, it is important to recall that out of the three modes of international public procurement, the GAO report captures primarily mode 1. However,

previous empirical work for all EU member states (e.g. Ramboll, 2011) provides evidence that, in fact, the most important avenue for international procurement is mode 2, followed by mode 3, while mode 1 is usually less important. The intuition behind this finding is clear: for a large number of products and services purchased by public authorities, proximity is key. Hence, the existing data seem to suggest that distance matters in public procurement and very often goods and services are procured from companies (foreign and domestic) located in the proximity of the procuring authorities.

In general, the actual cost-benefit analysis of engaging in international public procurement has to be based on two fundamental principles:

- All three procurement modes should be taken into account;
- A comparison of the coverage of public procurement markets, ‘de jure’ openness, and non-discrimination that companies face abroad, compared to the restrictions faced by foreign companies when bidding for public procurement contracts.

The first point was clearly illustrated in the previous section. On the second point, one has to recall that access of foreign firms to the US procurement market is still considerably affected by several discriminatory measures. It is important to note, for instance, that “Buy America(n)” provisions limit mode 3 procurement, by imposing restrictions on the ability of firms bidding for public contracts (both domestic and foreign) to source certain intermediate inputs from abroad.

Moreover, as eloquently pointed out by Anderson and Müller (2017), the legal guarantees the GPA offers against discriminatory measures in government procurement extend to public procurement by foreign subsidiaries in addition to direct cross-border trade. In that sense, it is prohibited to discriminate against locally established suppliers on the basis of “foreign affiliation or ownership”. Furthermore, the GPA also guarantees that suppliers are not discriminated on the basis of the origin of the goods and services offered. In other words, a US withdrawal from the GPA will not only put at risk the access of US firms to the substantial GPA cross-border procurement market, but, even more relevantly, may hamper the ability of US foreign subsidiaries and US suppliers along the value chain to bid for foreign contracts abroad.

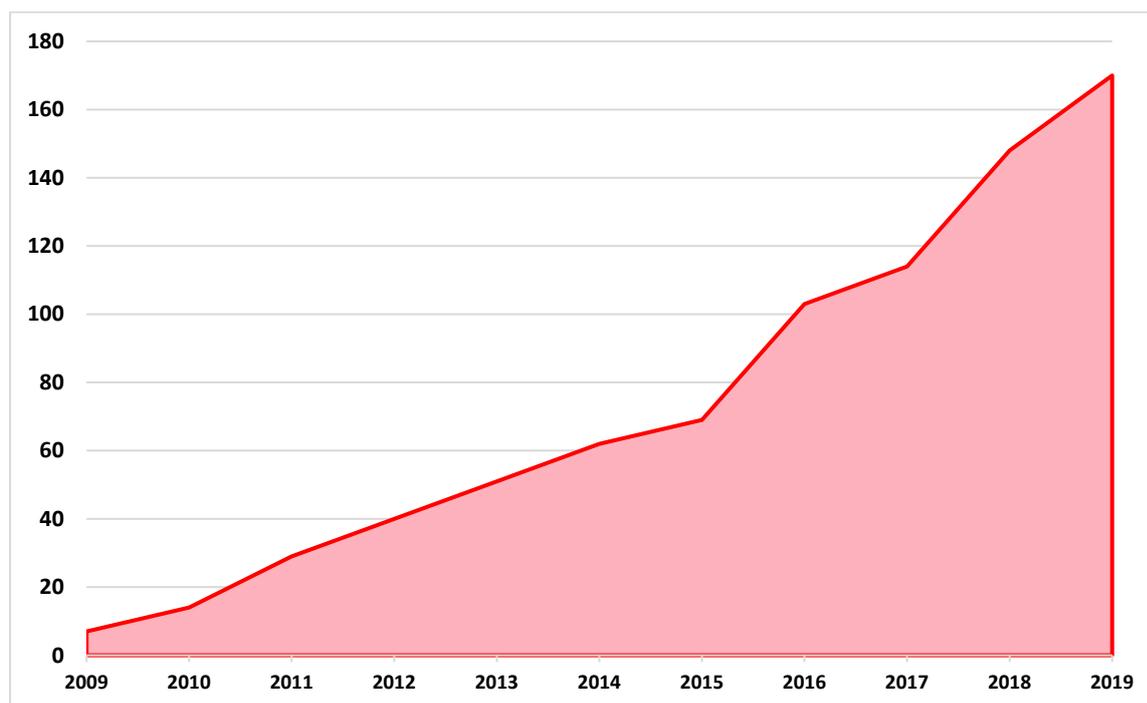
An assessment of removing “Buy America(n)” restrictions points to substantial benefits in terms of job creation and GDP gains for the US (Dixon et al., 2017). Thus, whenever such ‘buy-local’ provisions induce a costly change in the production patterns of potential foreign bidders, they will not only impose restrictions on mode 3 but, if the extra cost makes the foreign bid less attractive, it may also indirectly reduce market access via modality 1 and 2.

Without speculating about the likely magnitude of such restrictions on the ‘de facto’ openness of US public procurement, one is left solely with evidence on ‘de jure’ openness. The scope and discriminatory nature of local content requirements under ‘buy-local’ provisions are already well-known and documented (see, for instance, Luckey, 2012). The Global Trade Alert (GTA)

initiative has been monitoring protectionist tendencies worldwide affecting international trade, including government procurement, since 2009.<sup>2</sup>

The GTA database has documented a significant increase in the number of discriminatory policy interventions affecting the US public procurement market, with a steeper rise since 2016 (see Figure 3).

Figure 3. United States: cumulative number of new discriminatory procurement measures



Source: Own calculations, based on the GTA database (<https://www.globaltradealert.org/>). The chart reports only discriminatory (red) measures still reported as currently in place, as of 3 March 2020.

All of these measures but two are localisation requirements such as local content requirements and have a strong negative impact on procurement mode 3, directly affecting the ability of both US companies and foreign affiliates to source certain inputs from abroad. Overall, such discriminatory measures (with various degrees of domestic preferential treatment) tend to reduce the ability of foreign firms across all three procurement modalities to win public contracts in the United States.

Moreover, as pointed out by Anderson and Yukins (2020) only 37 out of 50 US states have opened (and only partially) their procurement markets under the GPA. The US also excludes federally-funded mass transit and highway projects and almost all municipalities from the GPA. The EU has a broader coverage of sub-central and public utilities in its GPA commitments. This asymmetry in the GPA coverage has been also pointed out by Grier (2017), who rightly argued that the right benchmark for comparing access to procurement markets should be based on

<sup>2</sup> For a description of the GTA methodology and the database see <https://www.globaltradealert.org/>.

the extent to which public entities and goods and services sectors coverage are included in the GPA commitments, as opposed to a dollar-for-dollar approach. For partners of asymmetric economic size, this would clearly be an inappropriate metric.

The various elements presented above point out three important facts. First, whether measured on a 'de facto' or 'de jure' basis, international openness in public procurement remains a major policy objective, as part of a globalized economy.

Second, for sound evidence-based policy advice, it is crucial to have a comprehensive assessment of openness of public procurement markets based on the three procurement modes, and not just mode 1 (cross-border procurement). The evidence provided in this short brief indicates that, when all three procurement modes are considered, GPA membership does translate into tangible economic opportunities for foreign companies through winning public contracts in the EU. Out of the €50 billion of EU public contracts awarded to foreign companies, US companies won EU public contracts worth more than €11 billion in 2017 alone.

Third, there is evidence that the current degree of US openness and GPA commitments in terms of market access across all three procurement modes and levels of US government (federal, sub-federal, and local) remains limited and is subject to a growing number of restrictions and discriminatory measures.

Therefore, when taking all these elements into consideration, judging the value of the US GPA membership based on a narrow and one-sided approach may be misguided. As the USMCA context clearly indicates, GPA membership offers a very solid and predictable market access environment for US companies. In its absence, a sizeable share of international public procurement currently offered to US companies by various GPA members would no longer benefit from these guarantees (Grier, 2020; Anderson and Müller, 2017).

A more promising way forward would be to deepen current GPA commitments, while improving the factual basis and the data reporting processes to ensure that all GPA members are fully informed about the benefits this important agreement confers on their economies.

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