Global Counsel

‘Ending naivety’? Implementing the EU International Procurement Instrument

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Summary

The European Commission’s decision to block the merger of Siemens and Alstom has triggered a new phase in the debate on European industrial policy. Wary of conceding its own prerogatives on competition to Paris and Berlin, the commission has proposed a range of alternative tools, including a renewed push for the International Procurement Instrument (IPI). Like last year’s new EU foreign investment screening framework, this is an idea that has been around for a while, but whose political time may now have come. In theory, the IPI would add an important new tool to the EU’s growing set of defensive mechanisms on Chinese trade and investment, allowing Brussels to penalise bidders for EU public procurement contracts from jurisdictions determined to be providing less-than-reciprocal market access in this area. Will it be adopted? And if it is adopted, will it ever be used?

The decision to prohibit the politically-charged Siemens/Alstom tie-up by EU antitrust regulators last month has triggered an important new phase in the EU’s debate on industrial policy. Critics, led by Paris and Berlin, have charged that Brussels has missed the strategic need to approve big mergers and support the development of European champions capable of exerting the kind of global industrial strength that Airbus has demonstrated over four decades.

As so often in these questions, China is the focus of much of the anxiety, in general and in this case. In 2015, Beijing supported the merger of CNR Group and CSR Group to create CRRC, the largest rolling stock manufacturer in the world, surpassing Siemens and Alstom in scale. Backed by Xi Jinping’s ambitious ‘Made in China 2025’ industrial strategy and with a firm eye on western public procurement markets, this huge new player is at the heart of the strategic logic of the Siemens-Alstom merger. Hence the frustration at the European Commission’s obstruction.

At a news conference following the EU Council Summit last month, French president, Emmanuel Macron, called for an “end to naivety” towards China. The commission’s response to the Franco-German call for a new agenda has been a familiar Brussels strategy of seeking additional outlets for the political pressure it recognises in the system. Reluctant to see the debate play out on the territory of its own prerogatives on competition policy, it has instead proposed a range of options that address concerns in Berlin and in Paris via alternative routes. One of the most interesting of these is the call for the council to reopen the long-standing EU debate on the IPI.

If this proves to be the moment at which the consensus for such a new instrument emerges, then it will in principle add a new front to the EU’s push for trade and investment reciprocity from international partners. Is this that moment? And what might the IPI actually mean for procurement trade?

How would the International Procurement Instrument work?

The genesis of the IPI goes back a decade and is rooted in a longstanding EU concern about international imbalance in public procurement markets. The EU argues that while it maintains an open public procurement market of €352 bn in value for members of the World Trade Organisation’s (WTO) Government Procurement Agreement (GPA), this is not genuinely reciprocated. Table 1 provides a strong impression of asymmetry – the estimated openness of the EU public procurement markets, at 85% is much larger than that of most of the EU’s trading partners which range from 0 to 75%.

The value of US procurement offered to foreign bidders in 2016 was €178 bn, and only a fraction of the Chinese public procurement market is open to foreign business. Only €10 bn of EU exports, or 0.08% of EU GDP, find their way in global procurement markets, whereas the commission estimates that €12 bn of further EU exports remains

Table 1 - European Commission's estimates of the openness of public procurement markets

	Size of PP markets covered by GPA (€bn)	*de jure* commitments (% of total PP markets above the GPA 1995 threshold)	*de facto* commitments (% of total PP markets above the GPA 1995 threshold)	
		GPA 1995	EU's partners	EU
	1	2	3	4
EU	370	85	-	-
USA	559	32	47	46
Japan	96	28	72	70
Canada	59	16	40	10
Korea	25	65	80	82
Israel	2	75	75	n/a
Mexico	20	75	92	n/a
China	83	0	24	0
Russia	18	0	56	0
India	19	0	70	0
Brazil	42	0	38	0
Turkey	24	0	25	0
Australia	29	0	63	0
Total non-EU	967	25	n/a	18

Source: IAWD Annex 3, Directorate-General for External Policies, 'Openness of public procurement markets in key third countries' (2017). [a] Column 2 presents the estimates of public procurement market openness based on the legal international commitments taken by the EU and 12 countries under the 1995 WTO GPA or bilateral preferential trade agreements as a percentage share of the value of the markets considered as open de jure in the total value of public procurement markets above the GPA thresholds. [b] Column 3 presents the estimates of public procurement market openness for the EU's partners on a de facto basis, measured by the percentage share of the value of the markets considered as open de facto in the total value of procurement markets above the GPA thresholds. [c] A market is considered as open de facto if a country does not apply protectionist measures in the public procurement markets that are not open de jure.

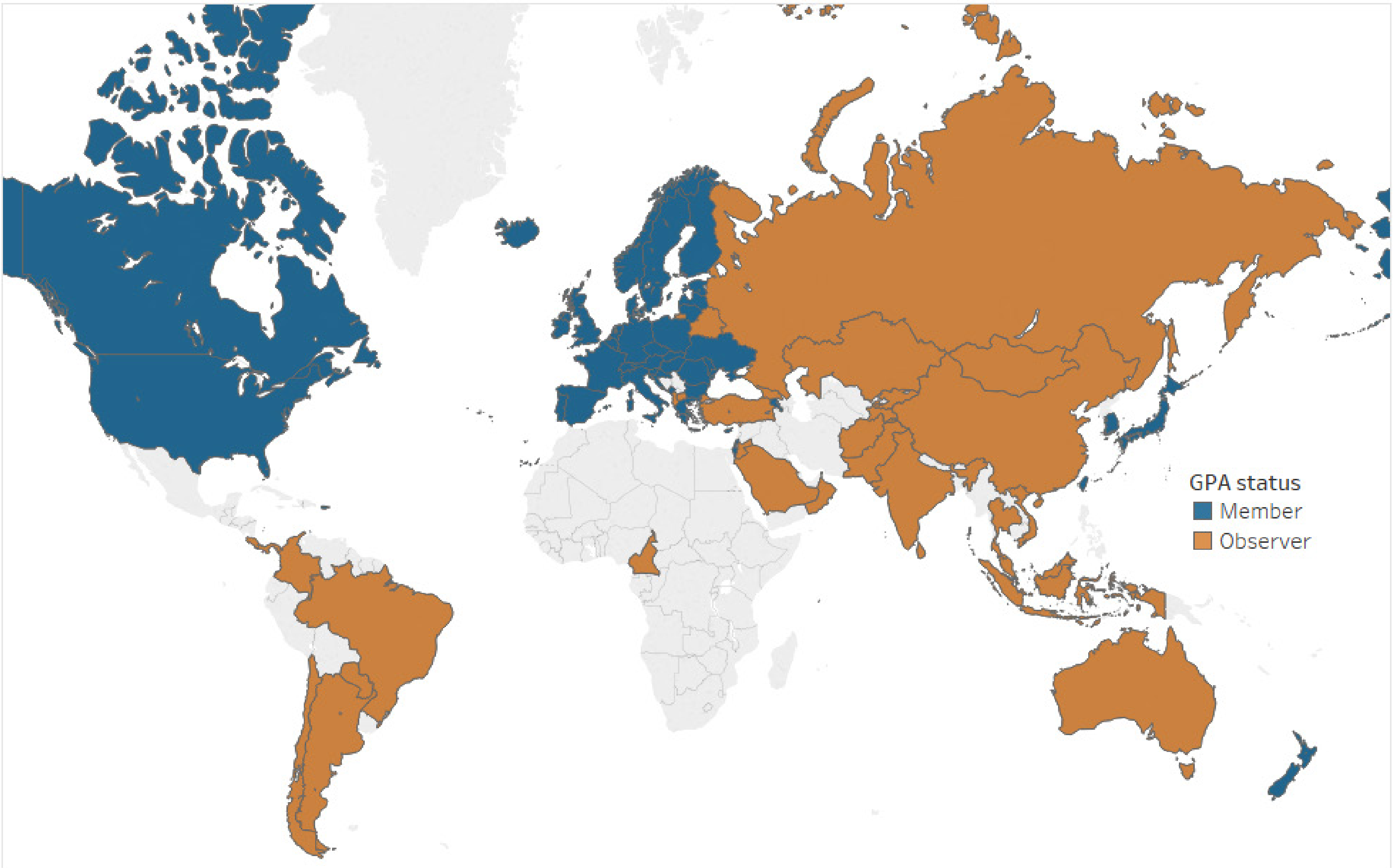
unrealised due to restrictions. This is the context in which the IPI is being dusted off as a potential answer to an unbalanced landscape in which China's policy is to be both hyper-competitive and closed to foreign competition.

When China became a WTO member in 2001, it committed itself to joining the GPA, and became a GPA observer in 2002. The GPA is a plurilateral agreement in which WTO members commit to open sectors and goods categories of their public procurement markets to foreign competition. Since 2007, China has submitted several accession offers, which have shown gradual improvements but which have been deemed insufficiently ambitious by GPA members in terms of their coverage of sub-central level entities and state-owned enterprises, which amounts to a gross under-coverage of China's government procurement. In the absence of such commitments, its markets remain tightly closed.

As it stands, EU public procurement directives do not provide a general framework for dealing with bids with foreign goods and services. The IPI first emerged in 2012 when the European Parliament called on the commission to develop a European instrument that would provide an overarching framework for addressing the level playing field in procurement. The commission-proposed instrument was first produced in 2013 and after three years of debate was resubmitted in January 2016 in a revised form, but stalled in a divided council.

Following member states' concerns of retaliation from China and other trading partners, the revised IPI limits the possible restrictive measures to price penalties and excludes the possibility of completely disqualifying the tender or a complete EU market closure. The amended instrument centralises decision-making to the commission to minimise the administrative burden on member states and contracting agencies, while protecting the bilateral relationship of European governments with third countries. The new IPI excludes most developing countries from its scope and can be targeted at regional or local levels to differentiate territories in case the discriminatory measures are only at the sub-central level. The amended proposal also includes an exemption from the application of the instrument to European SMEs. Finally, the proposal sets time limits on the commission to avoid lengthy investigations, and shifts the burden of proof to the

Government Procurement Agreement membership



Source: WTO, Agreement on Government Procurement https://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm

bidder by establishing a presumption that tenders submitted by companies originating in the targeted third country will be captured by the price penalty, unless they can demonstrate that less than 50% of the total value of their tender is made up of non-covered goods and services.

The IPI mirrors the protocols of a trade defence instrument. It gives the commission the power to initiate public investigations in cases of alleged discrimination of EU companies in procurement markets. The criteria for discrimination are not well defined. According to the 2016 proposal, the commission will first "examine to what degree the public procurement laws of the country concerned ensure transparency in line with international standards" and "preclude any discrimination against EU goods, services and economic operators" *de jure* or *de facto* by public authorities or individual procuring entities. If such restrictions are found on EU goods or services, the commission can invite the country concerned to consult or negotiate on the opening of its procurement market for up to 15 months. The commission can terminate such consultations if the country undertakes international commitments agreed with the union through accession to the WTO GPA or through bilateral agreement with the EU.

In the absence of satisfactory reciprocity, the IPI allows the commission to apply price adjustment measures to bids from that jurisdiction in the EU market. Such measures shall only apply to tenders where more than 50 percent of the total value of goods or services originate from a third country and which have an estimated value equal to or above €5m, exclusive of value-added tax. The measures add a penalty of up to 20% on top of the price of the tenders concerned, however this only applies to the evaluation process and does not determine the final price. In order to safeguard the essential public needs, for instance in the fields of health and public safety, or where the application of the measure would lead to a disproportionate increase in the price or costs of the contract, contracting authorities should be able to exempt non-covered goods and services from the price adjustment measures if there are no union and/or covered goods or services available which meet the requirements of the contracting authority. While China is the EU's primary target, the strategy would also apply to other markets where sufficient GPA commitments have not been made, such as Russia, Turkey, India, Indonesia, Japan and Korea.

'Ending naivety'?

There are two questions that now need answering. The first is whether the prospects for passing the IPI into law are materially better than the last two failed attempts. On balance, they must be. The commission has a political interest in securing credible alternatives to any encroachment on its say on competition policy and can be expected to press for adoption. France and Germany are supportive. The Romanian presidency is supporting the commission and has put the proposal on the agenda for its presidency discussion in the council. The new European Parliament can be expected to be robustly behind new tools.

In the past, opposition to this kind of 'reciprocity'-based approach to trade and investment has been met with opposition from northern European countries such as Sweden and the UK, often with German support. These states have argued that imposing higher costs on EU consumers – or taxpayers via public procurement buyers – is not a price worth paying for level playing field action that may not deliver change and can expose the EU's own exporters to retaliation.

However, the mood is different this time. It is no coincidence that the EU adopted its first pan-EU framework for investment screening last year, again after several attempts going back almost a decade. Last December, a group of ministers from 18 EU countries, including the euro zone's big four – France, Germany, Italy and Spain – backed the IPI proposal. Germany has shifted its position in its new industrial strategy, which calls for a hardening stance on public procurement through an amended version of the law.

Opposition is further weakened by the UK exiting the EU. Other critics of the IPI such as Italy, Malta and Greece who are keen to protect their own political capital with Beijing, might try and dilute the proposal further. Fourteen governments, mainly from eastern and southern Europe, have signed memorandums of understanding with China since the roll out of the Belt and Road Initiative last year and they will want to preserve the privileged position this has established with Beijing. But these states may struggle to head off the Franco-German push for a tougher line.

The second question is whether the tool, if adopted, will be more than just window dressing. High profile confrontations leading to economic sanctions with Beijing (or anyone else) have never been popular in Brussels or member state capitals. The EU has a long track record of pushing for opening public procurement markets, and while the commission has been careful to overtly hold to its own GPA commitments, the optics of using sanctions to encourage reciprocity will strike some policymakers as risky and retrograde. The anxiety in Brussels has always been that a tough approach simply encourages a partner like China to double down on its buy national strategies. Many in both capitals and Brussels would no-doubt hope that the deterrent effect of the IPI, or an investigation under its auspices, is strong enough to encourage negotiation, without requiring the commission to impose actual punitive measures. Whether this is realistic, time will tell.

This Global Counsel Insight note was written by Alessandra Baldacchino, Research Associate at Global Counsel.

To contact the author, email:
a.baldacchino@global-counsel.co.uk

The views expressed in this note can be attributed to the named authors only.

A: 5 Welbeck Street, London, W1G 9YQ
T: +44 (0)203 667 6500
E: info@global-counsel.co.uk
www.global-counsel.co.uk
@global_counsel