

## Summary

When the new year 2009 knocks on the door, it has been 10 years since China adopted the first national law on tendering; 7 years since China joined the World Trade Organization (WTO); 6 years since Chinese Government Procurement Law entered into force; 1 year since China initiated the negotiation process for the accession to the WTO plurilateral Agreement on Government Procurement (GPA), which China promised to do so “as soon as possible” 7 years ago. China’s government procurement policy now reaches a crossroad.

One way forward, as advocated and urged by the WTO and China’s major trade partners such as the EU and the US, would be the opening up of the vast Chinese government procurement market and the formal integration of the domestic procurement regulations with international rules should China choose to conclude the GPA accession negotiation in a timely manner as required and amend the domestic legal system accordingly. This would mean that foreign suppliers (at least those from GPA Parties) gain access to the competition of certain public contracts that are reserved for national suppliers previously, while Chinese suppliers may receive reciprocal treatment abroad; the reform of government procurement regime in China which has been ongoing for more than a decade and resulted in a number of inconsistent rules and institutional tensions, will gain a new momentum and finally head towards harmonization, coherence and certainty.

However, a number of signs are pointing at the other direction: China will not conclude the GPA accession process in the near future despite the external

pressure. Such signs include that China's initial offer is very limited with numerous derogations which is far from the expectation of GPA Parties; China has intensified the use of government procurement as policy tools to promote domestic industry and innovation, energy preservation and environmental protection since 2006; the legal and institutional preparation for the GPA accession is still at the primary stage with no sign of consolidation. In short, China is not ready, "mentally" or practically, for to join the GPA.

There are multiple external and internal factors contributing towards this unsatisfactory prospect. The GPA, even after its recent revision, is not fully equipped to deal with acceding countries with a large state sector<sup>1</sup>. Chinese policy makers and suppliers are not convinced that the benefit of GPA membership will outweigh its cost. Chinese government structure is complicated and the division between the Chinese government and state enterprises is difficult to ascertain, especially with regard to investment. The legal and institutional frameworks underlying current Chinese public procurement regime remain fragmented and incoherent.

At this crucial crossroad, it is important for China to identify the costs and benefits of the GPA membership and formulate its future decision on a detailed analysis on that basis. China's GPA Accession involves three major categories of costs: [i] loss of discretion to use public procurement as a tool to pursue industrial or other non-economic (such as social, environmental and political) policy objectives; [ii]

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<sup>1</sup> The challenges faced by the GPA have been highlighted by the current author in, Wang, Ping "Coverage of the WTO's Agreement on Government Procurement: Challenges of Integrating China and other Countries with a Large State Sector into the Global Trading System" (2007)10(4) *Journal of International Economic Law* 887-920

costs of undertaking negotiations; [iii] costs of implementation including establishing the supplier challenge mechanism. These costs, especially the tension regarding the extent to which China can continue to pursue industrial, social and environmental policies through government procurement under the GPA, resulted in the lack of political momentum

On the other hand, benefits of China's GPA membership are arguably uncertain. Such uncertainty arises from, firstly, GPA's coverage, based on reciprocal negotiation of entity lists, is lack of transparency and allows a number of derogations from MFN and national treatment principles. Secondly, it is not clear to what extent Chinese exporters are keen to gain the market access to GPA Parties' government procurement market. Thirdly, it is not clear to what extent Chinese state enterprises will benefit from market access provided by the GPA membership. Fourthly, market access provided by the GPA membership is not absolute in the sense that tariff applicable to covered goods and services and other non-tariff barriers, such as national security exclusions and anti-dumping measures, are not lifted altogether.

Despite the uncertainty associated with market access benefits provided by the GPA membership, the overall benefits of China's GPA accession, albeit only apparent in the long run, should not be underestimated. There is a strong argument that public spending should be conducted in a regulated, transparent and efficient way aiming at value for money. Increased foreign competition will to a great extent facilitate the savings in public expenditure and in turn enhance general welfare. Joining the GPA will arguably increase transparency in government procurement and reduce

corruption. Joining the GPA will entrench Chinese central government's position in the fight against local protectionism which has fragmented the national market and impeded the development of national economy. Lastly, but not the least, while the implementation of the GPA poses significant challenge to Chinese domestic procurement regime, GPA accession is also a great opportunity to improve China's public procurement legal framework.

Due to the complexity of the factors contributing to these challenges, it is not realistic to provide a comprehensive package of solutions. It is suggested that the success of China's GPA accession depends on the clear awareness of significant challenges, the mutual understanding between China and GPA Parties of each others' expectations and constraints, as well as a culture of corporation instead of confrontation in the negotiation.

# China's Government Procurement Policy at the Crossroad

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## I. The GPA and China's Accession Process

Government procurement, while it is important for international trade<sup>3</sup>, has been largely excluded from the reach of the multilateral regulation under the WTO<sup>4</sup>. China's trade partners have made considerable efforts, before and after China's WTO accession, to persuade China to join the WTO Agreement on Government Procurement (GPA)—a plurilateral agreement aiming at developing disciplines regulating government procurement in the absence of multilateral rules.

After 5 years of intensive discussion, on December 28th, 2007, China's Financial Minister Xie Xuren signed a written application on behalf of China for joining the GPA which was submitted to the WTO Secretariat by the Permanent Mission of the People's Republic of China.<sup>5</sup> This application, which includes an offer of GPA

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<sup>3</sup>For the OECD countries as a whole, the ratio of total procurement (consumption and investment expenditure) for all levels of government is estimated at 19.96% of GDP or \$ 4733 billion, and for the non-OECD countries it is estimated at 14.48% of GDP or USD 816 billion; total government procurement worldwide is estimated to be roughly equivalent to 82.3% of world merchandise and commercial services exports in 1998; the value of potentially contestable government procurement markets worldwide is estimated at USD 2083 billion, which is equivalent to 7.1% of world GDP or 30.1% of world merchandise and commercial services exports in 1998. See OECD, *The Size of Government Procurement Market*, offprint from (2003)1(4) *OECD Journal on Budgeting*. For further discussion of the importance of public procurement see Arrowsmith, S., Linarelli, J. and Wallace, J. D. *Regulating Public Procurement: National and International Perspectives* (KLI: The Hague. London. Boston)(2000), p. 7-11

<sup>4</sup> Government procurement was excluded from basic WTO non-discrimination obligations (national treatment and MFN) by virtue of the so-called "government procurement exclusion" contained in GATT Articles III.8, XVII.2 and GATS Article XIII.1For further discussion on the application of GATT and GATS and other multilateral agreements to government procurement see Arrowsmith, S. *Government Procurement in the WTO* (The Hague, London, New York: Kluwer Law International)(2003), Ch. 3.

<sup>5</sup> See GPA/93 of 14 January 2008, available at [www.wto.org](http://www.wto.org). For news coverage of the application see

coverage (the so-called “Appendix I offer”), signaled the initiation of China’s GPA accession process.<sup>6</sup>

The current GPA (GPA 1994) was signed in Marrakesh on 15 April 1994 and entered into force on 1 January 1996. GPA 1994 is a plurilateral agreement which applies to WTO Members that choose to be parties to it. At present, the membership of GPA is still limited and the majority of developing countries are excluded. GPA 1994 contains a built-in mandate for its review.<sup>7</sup> As a result of the recent review process, a revised text (hereinafter GPA 2007) was provisionally agreed on 8 December 2006.<sup>8</sup> Its entry into force is still subject to a mutually satisfactory outcome on the coverage expansion negotiations which were intended to be concluded in 2007 but has not happen yet. GPA 2007 differs from GPA 1994 on some substantial aspects particularly relevant to accession negotiations, such as the scope of covered procurement and the treatment of developing countries. China has clearly express its intention to base the negotiation on GPA 1994 instead of GPA 2007 since it is not yet in force. Nevertheless, taking into consideration the length of the access negotiation process (18 month or more) and the likelihood GPA 2007 will be adopted during that

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<http://finance.sina.com.cn/g/20071228/18121896035.shtml>, visited on 1 January 2008.

<sup>6</sup> The Chinese version of the offer is available at [http://www.gov.cn/gzdt/2008-05/13/content\\_971032.htm](http://www.gov.cn/gzdt/2008-05/13/content_971032.htm). An Appendix I offer sets out the proposed commitments of prospective Parties to the GPA with respect to coverage of their various procuring entities under the Agreement and provides a basis for related negotiations with existing Parties.

<sup>7</sup> Article XXIV.7(b) of GPA 1994 requires the parties to review the GPA within three years of its entry into force (1995) and “periodically” thereafter, with a view both to “improving” the Agreement and to extending coverage.

<sup>8</sup> GPA/W/297, 11 December 2006. The revised text is available on <http://docsonline.wto.org/DDFDocuments/t/PLURI/GPA/W297.doc>. For comments see Anderson, R. D. “Renewing the WTO Agreement on Government Procurement: Progress to Date and Ongoing Negotiations” (2007)16(4) *Public Procurement Law Review* pp. 255-273; Silva, “The Revision of the WTO Agreement on Government Procurement: to what extent might it contribute to the expansion of current membership” (2008)17(2) *Public Procurement Law Review* 61-98.

period, the discussion will be primarily based on GPA 2007 and its differences with GPA 1994 will be highlighted where necessary.

## **II. Costs and Benefits to be Considered at the Crossroad**

The underlying political and institutional frameworks provide the driving force and the instrument for the success of the accession negotiation. If challenges of political and institutional nature are not properly identified and tackled, subsequent dialogue on technical and legal issues may well be rendered into an endless “game playing with word” and is not likely to produce real progress.

It is evident that there is a lack of political momentum from the Chinese side. China took passive and defensive position with regard to GPA membership before and after WTO accession. During the WTO accession negotiation, China firmly rejected the proposition that the GPA membership should be the precondition for China to join the WTO. Although China committed to join the GPA “as soon as possible” upon WTO accession<sup>9</sup>, it was only in April 2006 that China made the first concrete move: a commitment to table an offer of GPA coverage (the so-called “Appendix I offer”) by the end of 2007.<sup>10</sup> This was largely a result of the immense pressure asserted by the US in bilateral trade talks.

The lack of political momentum is arguably the most significant challenge for China’s GPA accession. Although the WTO Committee on Government Procurement has

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<sup>9</sup>WTO, *Accession Protocol of China*, WT/L/432, at paragraph 1.2; *Report of the WTO Working Party on the Accession of China* (1 October 2001), WT/ACC/CHN/49, at para.341-342.

<sup>10</sup> The U.S.-China Joint Commission on Commerce and Trade (JCCT) Outcomes on U.S. Requests, April 11, 2006, available at [http://www.commerce.gov/opa/press/Secretary\\_Gutierrez/2006\\_Releases/April/11\\_2006\\_JCCT\\_Outcomes\\_Factsheet.htm](http://www.commerce.gov/opa/press/Secretary_Gutierrez/2006_Releases/April/11_2006_JCCT_Outcomes_Factsheet.htm), visited on 1 May 2006. This commitment was later confirmed in the course of China’s first WTO Trade Policy Review in 2006, see WT/TPR/M/161, at paragraph 156.

adopted an “Indicative Time-Frame for Accession Negotiations and Reporting on the Progress of Work” which requires the negotiation to be concluded in 18 months, the time-frame is nevertheless “indicative” and not a strict deadline.<sup>11</sup> If Chinese negotiators, policymakers and domestic suppliers are not fully convinced that the benefit of GPA membership will outweigh its cost, even after the accession negotiation was initiated, the journey towards a satisfactory outcome may well be a lengthy and painful one.

This lack of political momentum is largely due to the fact that there is no extensive and convincing costs and benefits analysis favouring China’s GPA accession.

**A. Costs of GPA accession are rising.**

China’s GPA Accession involves three major categories of costs: [i] loss of discretion to use public procurement as a tool to pursue industrial or other non-economic (such as social, environmental and political) policy objectives; [ii] costs of undertaking negotiations; [iii] costs of implementation including establishing the supplier challenge mechanism.

In particular, costs of losing discretion in pursuing, through government procurement, industrial, social, environmental and political policy objectives are significant and likely to increase since China has intensified such practice in the last two years. While the “buy national” policy introduced in 2002 had not initially created significant additional barrier for foreign suppliers, Chinese government, since 2006, has adopted a number of national laws, regulations and policies to promote, through

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<sup>11</sup> WTO, Committee on Government Procurement, “Indicative Time-Frame for Accession Negotiations and Reporting on the Progress of Work-Note by Secretariat”, GPA/W/109/Rev.2, 3 January 2001.

government procurement, “indigenously innovated products”, “energy-saving products”, and “environmentally friendly products”.

Government procurement has been used to protect national industries, especially small and medium enterprises and infant industries (such as the software industry); to pursue social or environmental objectives, such as development of less-developed regions, support of disadvantaged social groups, certain minorities and promotion of energy-saving or environment-friendly products; and even to address human rights concerns<sup>12</sup>. Since such practices will require direct or indirect discrimination in favour of certain national suppliers (e.g. based in certain less-developed region) or foreign suppliers (e.g. those who are willing to transfer technology), the GPA rules, especially national treatment and MFN obligations and the rules on offsets, will curtail such discretion.

Article 9 of Chinese *Government Procurement Law* (entered into force on 1 January 2003) requires that “government procurement should assist the achievement of such national policy objectives of economic and social development as environment protection, the development of less developed and minority-populated areas, and the development of small and medium sized enterprises, etc.” Article 10 of the *Government Procurement Law* also introduced a “buy national” policy.<sup>13</sup> The

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<sup>12</sup> This is evident in the *Burma/Massachusetts* dispute. A Massachusetts law, which was later declared unconstitutional by the US Supreme Court, had barred procuring entities of the Massachusetts state government from buying goods or services from any person identified on a "restricted purchase list" of those doing business with Myanmar to protest Myanmar's human rights record. *United States – Measures Affecting Government Procurement – Constitution of the Panel Established at the Request of the European Communities and Japan* (21 October 1998, WT/DS88/4, WT/DS95/4). For academic comments see Arrowsmith, S. *Government Procurement in the WTO* (The Hague, London, New York: Kluwer Law International)(2003), Ch.13, at 327-328 and works cited there.

<sup>13</sup>It provides that procuring entities shall procure domestic goods, construction and services unless: 1)the

*Promotion of Small and Medium Enterprises Law* (entered into force on 1 January 2003) provides in Article 34 that “government procurement shall give preference to products or services supplied by SMEs.”

For several years, these provisions, due to the lack of implementing measures, were “toothless” although the government set up a clear target using government procurement to “support office software, computer and automobile industry with a view to enhancing the competitive capacity of domestic enterprise”<sup>14</sup>. For example, it is reported that in 2005, a local government branch in Jiang Xi Province indicated in its notice for procurement of air-conditioning machine that only foreign brands are qualified to participate.<sup>15</sup>

However, China has intensified the use of government procurement to pursue industrial, social and environmental policy objectives since 2006. First of all, the “buy national” policy was finally implemented in 2007 through a MOF *Measure on Government Procurement of Imported Products*<sup>16</sup> which requires imported products can only be procured with the approval of competent authorities in accordance with certain requirements and independent expert opinion and preference should be given to foreign suppliers offering offsets such as transfer of technology.

Secondly, mandated by a central government 15 years’ strategy on promotion of

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subject of procurement is not available or cannot be acquired on reasonable commercial terms; 2) the subject is procured with a view for use abroad; 3) otherwise provided by laws and administrative regulations.

<sup>14</sup> State Council Secretariat, “Opinion on the Promotion of Government Procurement Reform drafted by Ministry of Finance” [2003] No.74, Article 2, author’s translation. Chinese version is available at <http://www.ccg.gov.cn/purfagui/fagui.jsp>.

<sup>15</sup> See <http://www.ccg.gov.cn/puralfx/anlifx.htm>, in Chinese, visited on 1 October 2007.

<sup>16</sup> Ministry of Finance, MOF Treasury [2007] No. 119, December 17, 2007. Chinese version is available at <http://www.ccg.gov.cn/purfagui/fagui.jsp>.

science and technology<sup>17</sup>, a number of administrative decrees and procurement regulations have been adopted during 2006-2007 to facilitate procurement of “indigenous innovation” products, “energy-efficient” products and products certified as environmentally friendly.<sup>18</sup> The regulations on procurement of “indigenous innovation” products also contain explicit references to the price preference program and offsets. Article 11 of the *MOF Measure on the Administration of Contract on Government Procurement of Indigenous Innovation Products* provides that “once approved to purchase foreign products, the contract should preferably be awarded to the foreign enterprise which undertakes to transfer the core technology”.<sup>19</sup> Article 13-17 of *MOF Measure on the Evaluation of Government Procurement of Indigenous Innovation Products* provides that indigenously innovated products shall be given preference at a margin of 5-10 % in case the price is the sole determining factor and otherwise 4-8%.<sup>20</sup> For “energy-efficient” products and products certified as environmentally friendly, the regulations merely require that preference shall be given to such products contained in lists promulgated by the competent authorities

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<sup>17</sup> *State Council Opinions on Policies to Implement the National Medium and Long Term Outline for the Development and Planning of Science and Technology (2006-2020)*, No. 6 of the State Council Office(2006), Chinese version is available at [www.ccgp.gov.cn/](http://www.ccgp.gov.cn/).

<sup>18</sup> *MOF Measures on Budget Administration of Government Procurement of Indigenous Innovation Products*, MOF Treasury Decree [2007] No. 29, 3 April 2007; *MOF Measure on the Evaluation of Government Procurement of Indigenous Innovation Products*, MOF Treasury Decree [2007] No. 30, 3 April 2007; *MOF Measure on the Administration of Contract on Government Procurement of Indigenous Innovation Products*, MOF Treasury Decree [2007] No. 31, 3 April 2007. These above-mentioned regulations (Chinese version) are available at [www.ccgp.gov.cn/](http://www.ccgp.gov.cn/). State Council Notice on Establishing the Mechanism for Mandatory Procurement of Energy Saving Products, State Council Secretariat Notice [2007] No. 51, 30 July 2007, Chinese version available at [http://www.gov.cn/zwggk/2007-08/06/content\\_707549.htm](http://www.gov.cn/zwggk/2007-08/06/content_707549.htm). MOF and State Environmental Protection Administration, *Opinions on Procurement of Environment Certified Products*, MOF Treasury Decree [2006] No.90, entered into force on 1 January 2007.

<sup>19</sup> MOF Treasury Decree [2007] No. 31, 3 April 2007. Chinese version is available at [www.ccgp.gov.cn/](http://www.ccgp.gov.cn/).

<sup>20</sup> MOF Treasury Decree [2007] No. 30, 3 April 2007. Chinese version is available at [www.ccgp.gov.cn/](http://www.ccgp.gov.cn/).

without specifying the margin or detailed procedure.<sup>21</sup>

Chinese government's determination to pursue industrial and environmental policies through government procurement is clearly demonstrated by this wave of coordinated procurement regulations. It can be argued that such practices are in general incompatible with the GPA. Although a domestic price preference program and offsets may enable China to retain certain policies promoting indigenous innovation products and technology transfer, such transitional measures will have to be negotiated and are confined to a relevantly short transitional period. With regard to giving preference to energy-saving and environmentally friendly products, although GPA 2007 Article X:6 allows a Party to "prepare, adopt, or apply technical specifications to promote the conservation of natural resources or protect the environment", the current practice may nonetheless be incompatible. This is because the lists of products are determined by administrative organs paying little regards to international or equivalent foreign standards, which is arguably inconsistent with the requirement contained in GPA 2007 Article X:3.<sup>22</sup> Furthermore, it will be difficult, if possible at all, for China to incorporate derogations in its Annexes as the GPA Parties are trying to eliminate existing derogations providing discretion to pursue national policy goals.

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<sup>21</sup> Article 51 of the amended *Law on Energy Saving* (entered into force on 1 April 2008) also requires preference shall be given in government procurement to energy-saving products listed in the official catalogue without specifying any implementing measure.

<sup>22</sup> It provides that "[W]here design or descriptive characteristics are used in the technical specifications, a procuring entity should indicate, where appropriate, that it will consider tenders of equivalent goods or services that demonstrably fulfil the requirements of the procurement by including words such as 'or equivalent' in the tender documentation."

In addition to concerns of the GPA compatibility, it can be argued that the effectiveness of China's practices in pursuing industrial and other policies through government procurement is also in question. This is because, firstly, the scope of preferred products is determined by a list drafted by government ministries taking into consideration but not subject to the finding of professional agencies or international standards. Secondly, while each type of products requires to be given preference, no regard has been paid to the possible overlap scenario. For example, if a government agency wants to purchase copy machines, it is hard for the agency to decide whether to give preference to energy efficient ones or environmental friendly ones, both compulsory under relevant regulations. Thirdly, the cost of maintaining such practices, *inter alia*, increased expenditure, has not been properly considered by Chinese policy makers. It is suggested that the role of government procurement in promoting industrial policy and achieving social justice is after all limited.<sup>23</sup>

In the past few years, Chinese government has also used procurement of state enterprises to address issues of political/diplomatic nature, namely to ease the anxiety of American public and Congress about the huge Sino-US trade deficit<sup>24</sup>, despite that China committed upon WTO accession that "all state-owned and

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<sup>23</sup> McCrudden, C. *Buying Social Justice: equality, government procurement, and legal change* (Oxford : Oxford University Press) (2007).

<sup>24</sup> Prior to Chinese President Hu Jintao's visit to US in April 2006, a delegation consisting of more than 100 state enterprises headed by Vice Premier Wu Yi signed in Los Angeles on April 6 an array of procurement contracts worth 4.44 billion U.S. dollars involving 27 projects, ranging from software, power generation equipment to automobiles and electronic products. The total value of the procurement of this delegation was estimated around 15 billion US dollars. [http://www.chinadaily.com.cn/china/2006-04/07/content\\_562922.htm](http://www.chinadaily.com.cn/china/2006-04/07/content_562922.htm), visited on 19/06/06.

state-invested enterprises would make purchases and sales based solely on commercial considerations”<sup>25</sup>. Such policies and practices, which are formulated and favoured by the top leadership, will have to be limited or eliminated once China join the GPA provides that those state enterprises are covered.

Furthermore, the Chinese public procurement regime is still evolving and is not yet qualified as a coherent and unified legal framework. As pointed out by the current author and other commentators, the tension between two national laws on public procurement—the *Tendering Law* and the *Government Procurement Law* -has significantly undermined the coherence of the domestic public procurement legal framework and legal certainty.<sup>26</sup> Such tension is resulted, in particular, from the overlap of their coverage.

While the *Tendering Law* applies to “all tendering proceedings”<sup>27</sup>, the *Government Procurement Law* applies to all government procurement<sup>28</sup>. The *Government Procurement Law* has tried to reconcile the coverage of these two national laws by providing in Article 4 that “[T]he *Tendering Law* shall apply to tendering proceedings

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<sup>25</sup> The representative of China confirmed that “China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g., price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement.” Paragraph 46 of Section II: 6 (titled State-Owned and State-Invested Enterprises), Report of the WTO Working Party on the Accession of China, WT/MIN(01)/3, 10 November 2001.

<sup>26</sup> See Wang, P. “China’s Evolving Legal Framework on Public Procurement” (2004)(6) *Public Procurement Law Review* 285-318; Cao, Fuguo, “From Tendering law to the Public Procurement Law” in Arrowsmith, S. and Trybus, M. eds., *Public Procurement: The Continuing Revolution* (London: Kluwer Law International)(2003).

<sup>27</sup> Article 2 of the *Tendering Law*.

<sup>28</sup> Article 2 of the *Government Procurement Law* defines government procurement as “all purchasing activities conducted using fiscal funds by state organs at all levels, institutions and social organizations when the goods, construction and services concerned are listed in the Centralized Procurement Catalogue or the value of which exceeds the respective Prescribed Procurement Thresholds for goods, construction or services as applicable.”

in government procurement of construction”. However, it remains unclear [i] which law will apply to government procurement of construction related goods and services; [ii] whether provisions on “buy national” policy, secondary policy, publicity, challenge and review mechanism contained in the *Government Procurement Law* should apply to government procurement of construction through tendering proceedings, taking into consideration that the *Tendering Law* does not contain such provisions. The overlap between the coverage of administrative regulations adopted for the implementation of these two national laws illustrated that the conflict remains to be resolved.

Such fragmentation of the domestic legal framework will arguably have a profound impact on the implementation of GPA. It will be difficult to ensure compliance with GPA obligations if the proper instrument for such implementation can not be ascertained at the first place. Although it is theoretically possible to modify both laws in accordance with GPA provisions, such an approach will result in a waste of resources, complexity and uncertainty, especially taking into consideration that the *Tendering Law* applies to tendering conducted by both public and private entities and a significant number of them will not be covered by the GPA.

Furthermore, the extent to which procurement of Chinese state enterprises is covered by the national procurement law is not entirely clear. In order to ensure the regulations and practices regarding covered procurement of covered state enterprises comply with GPA requirements, a new instrument specially designed for regulating procurement of state enterprises, even limited to those covered by the

GPA, is arguably desirable. However, the adoption of such an instrument will need considerable efforts to coordinate among various government authorities with vested interest in regulating state enterprises. The lack of a unified institutional framework, which has been suggested as the root for the continuous conflict between two national procurement laws, is likely to jeopardize these efforts.

**B. Benefits of China's GPA membership are arguably uncertain.**

Accession to the GPA will entail a number of benefits and in the long term the benefits of liberalizing government procurement should outweigh the costs of abandoning protectionist procurement, as in the case of general trade liberalization.<sup>29</sup> For an economic perspective, benefits of the GPA membership include: first, and most directly, exporters of the acceding country will gain access to GPA Parties' government procurement markets; secondly, greater competition from foreign bidders following the opening up of domestic procurement market will enable the government to make budgetary savings by obtaining better value for money; thirdly, on the supply side, liberalization of public procurement market will curtail the last privilege that domestic, normally deficient, firms enjoy, which will inevitably force them to cut down cost and raise efficiency in order to survive since there is no more "free-lunch". From a political perspective, mandatory obligation of the GPA will help the acceding country to set up an efficient and independent domestic procurement regime which is immune from internal political pressure or personal influence with

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<sup>29</sup> See Arrowsmith, S. *Government Procurement in the WTO* (The Hague, London, New York: Kluwer Law International)(2003), Ch. 1; for trade liberalization in general, see Krugman and Obstfeld, *International Economics: Theory and Policy* (5<sup>th</sup> ed. 2000), Part I.

benefit of helping to combat corruption and regionalism; GPA membership will also enable a government to influence the development of international policy making on government procurement.

However, except instant access to GPA Parties' government procurement market, other benefits are in a long run and less obvious. Furthermore, it can be argued that potential gains in market access are uncertain, especially with regard to China.<sup>30</sup>

Such uncertainty arises from, firstly, GPA's coverage, based on reciprocal negotiation of entity lists, is lack of transparency and allows a number of derogations from MFN and national treatment principles.<sup>31</sup> The complexity of the GPA coverage makes it difficult for acceding countries to ascertain opportunities available at GPA Parties' procurement markets. There is no economic study available to inform the extent of business opportunities created by the GPA membership.<sup>32</sup>

Secondly, it is not clear to what extent Chinese exporters are keen to gain the market access to GPA Parties' government procurement market. Unlike other developing countries whose domestic suppliers are generally not in a position to compete in a worldwide market and mainly offering primary commodities, Chinese exporters have already made a strong presence in GPA Parties' national markets. For example, in the period from January to September 2007, China was the No. 1 exporter to the US

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<sup>30</sup>For developing countries in general, see Silva, "The Revision of the WTO Agreement on Government Procurement: to what extent might it contribute to the expansion of current membership" (2008)17(2) *Public Procurement Law Review* 61-98, section 5.2.2, at pp.73-76 and 5.2.6, at pp.79-80.

<sup>31</sup> Arrowsmith, S. *Government Procurement in the WTO* (The Hague, London, New York: Kluwer Law International)(2003), at 16.2; Hoekman and Mavroidis, "The WTO's Agreement on Government Procurement: Expanding Disciplines, Declining Membership?"(1995) 4 P.P.L.R. 63 at 75

<sup>32</sup> One such study exists with regard to the effect of the predecessor of the GPA-the Tokyo Round Agreement. Hoekman, "Operation of the Agreement on Government Procurement, 1983-1992", Ch.5 in Hoekman and Mavroidis (eds.), *Law and Policy in Public Purchasing: the WTO Agreement on Government Procurement* (1997).

with 234.4 billion worth of exports for which mechanical and electrical products accounted almost half(43.2%).<sup>33</sup> In addition, a number of Chinese suppliers have gained indirect access to GPA Parties' public market through supplying parts to western companies. However, the strength of Chinese exporters also means that they stand a better chance to benefit from the market access gained through GPA membership in comparison with other developing countries' suppliers. In order to mobilize Chinese exporters to support and lobby for the GPA accession, evidences of "extra" market opportunities provided by the GPA membership are arguably necessary.

Thirdly, it is not clear to what extent Chinese state enterprises will benefit from market access provided by the GPA membership. The initial response of Chinese sector associations (mainly consisting of state enterprises) with regard to GPA accession is not favorable due to the lack of identifiable commercial interests.<sup>34</sup> On the one hand, main destinations of exports of Chinese state enterprises are Asian and African developing countries' markets.<sup>35</sup> On the other hand, most large national infrastructure projects have been awarded to state enterprises. If those state enterprises, which have great influence on government policy, regard domestic public contract as easier to get in comparison with GPA Parties' government

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<sup>33</sup> Ministry of Commerce, Sino-US Trade Report 2007, available at [http://countryreport.mofcom.gov.cn/assay/view.asp?news\\_id=7585](http://countryreport.mofcom.gov.cn/assay/view.asp?news_id=7585), visited on 8 March 2008.

<sup>34</sup> Information provided by a participant of Chinese negotiation team.

<sup>35</sup> This was demonstrated by the reports of the State-Owned Assets Supervision and Administration Commission on "Overseas Expansion of Centrally Controlled State Enterprises" available at <http://www.sasac.gov.cn/n1180/n1226/n2410/n314289/index.html>, visited on 1 March 2008. It was also reported in 2007 that China encouraged state enterprises' operation in Africa by providing large loans to African countries with a precondition to purchase goods or services from "designated" Chinese enterprises. See Jamil Anderlini, "China insists on 'tied aid' in Africa", Jun 25, 2007, available at [www.ft.com](http://www.ft.com), visited on 21/02/2008.

contracts, their lobbying force is likely to be used against the membership the GPA. Fourthly, market access provided by the GPA membership is not absolute in the sense that tariff applicable to covered goods and services and other non-tariff barriers, such as national security exclusions and anti-dumping measures, are not lifted altogether. For example, Chinese suppliers are concerned that GPA Parties will exclude them from government procurement on the ground of national security.<sup>36</sup> Such concern was given rise by the “Lenovo Case” in 2006 which was referred by Chinese government source as the “Security Gate” incident.<sup>37</sup> It is reported that by the end of 2006, EC has initiated 131 anti-dumping investigations against Chinese products, which increased the risk of Chinese exports to EC.<sup>38</sup>

### **C. The overall benefits of China’s GPA accession should not be underestimated**

Despite the uncertainty associated with market access benefits provided by the GPA membership, the overall benefits of China’s GPA accession, albeit only apparent in the long run, should not be underestimated. Firstly, there is a strong argument that public spending should be conducted in a regulated, transparent and efficient way

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<sup>36</sup> Article XXIII:1 of GPA 1994 (and Article III:1 of GPA 2007) provides that “[N]othing in this Agreement shall be construed to prevent any Party from taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or for national defence purposes.”

<sup>37</sup> On May 18th America's State Department said it would not use 16,000 computers it recently bought from Lenovo, a Chinese firm, for sensitive "classified" work. Although the Chinese Academy of Sciences indirectly owns around 27% of Lenovo, Lenovo is based in New York and has an American chief executive. The State Department's PCs were assembled in former IBM plants in Mexico and North Carolina, following America's strict procurement standards. See “Classify this” *Economist*, 00130613, 5/27/2006, Vol. 379, Issue 8479. For Chinese comments, see <http://www.ccg.gov.cn/lenovo>, visited on 5 May 2007.

<sup>38</sup> Ministry of Commerce, Country Specific Report on Environment for Trade and Investment: EC, in Chinese, p. 30, available at <http://gpj.mofcom.gov.cn/accessory/200704/1177551761158.pdf>, visited on 8 March 2008.

aiming at value for money. Increased foreign competition will to a great extent facilitate the savings in public expenditure and in turn enhance general welfare. According to the Ministry of Commerce, during the period of Seventh to Ninth Five Years Plan (1985-2000), the rate of savings achieved through procurement of mechanical and electronic products using international tendering has been estimated as respectively: 16.95% of 18 billion Yuan (1985-1990); 15.5% of 48 billion Yuan (1991-1995) □ 16.8% of 223.6 billion Yuan (1996-2000).<sup>39</sup>

Secondly, joining the GPA will arguably increase transparency in government procurement and reduce corruption. An “anti-corruption agenda” has been added in GPA 2007 which provides in its preamble “the importance of transparent measures regarding government procurement, of carrying out procurements in a transparent and impartial manner, and of avoiding conflicts of interest and corrupt practices, in accordance with applicable international instruments, such as the United Nations Convention Against Corruption” shall be recognized and requires procuring entities to conduct covered procurement in a transparent and impartial manner that “avoids conflicts of interest” and “prevents corrupt practices” (Article V:4 GPA 2007). Since corruption is a major problem in Chinese society as identified by the top leadership, the new “anti-corruption agenda” in GPA 2007 help to generate support for China’s GPA accession.<sup>40</sup>

Thirdly, joining the GPA will entrench Chinese central government’s position in the

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<sup>39</sup> <http://www.sasac.gov.cn/gvqydt/dfdt/200607060174.htm>, visited on 19/06/2006.

<sup>40</sup> Chinese leaders have recognized that “anti-corruption and building a clean government is an important strategic mission.”, President Hu Jintao’s speech to mark the 85th anniversary of the party’s founding , <http://news.bbc.co.uk/1/hi/world/asia-pacific/5131978.stm>, visited on 15/07/2006.

fight against local protectionism which has fragmented the national market and impeded the development of national economy. While government procurement is a non-tariff barrier in the international trade, discriminatory procurement by Chinese local government and state enterprises under their control, is arguably a significant barrier of internal trade. As identified by the State Council *Regulation on Forbidding Regional Block in Economic Activities in the Market* (State Council Order No. 303, enacted and entered into force on 21 April 2001), measures creating a regional block include, inter alia, [i] “require, through any means, any unit or individual only to purchase locally-manufactured products or services provided by local enterprises”(Article IV:1); [ii] “apply different technical specifications, inspection criteria or other discriminatory measure to non-local products or services in order to restrict the entry of non-local products or services into local market”(Article IV:4); [iii] “restrict participation of non-local enterprises to local tendering process through setting up discriminatory qualification criteria or contract award criteria, or holding up contract information and etc.”(Article IV:6).

Lastly, but not the least, while the implementation of the GPA poses significant challenge to Chinese domestic procurement regime, GPA accession is also a great opportunity to improve China’s public procurement legal framework. It should be recognized that mandatory requirement for the national procurement legislation to comply with the GPA will help to entrench the position of reformers to harmonize the fragmented domestic procurement regime.

To sum up, with direct gains in market access provided by GPA membership

arguably uncertain and Chinese policy makers intensifying the use of government procurement for industrial and other policy objectives, the lack of political momentum for GPA accession is disappointing but inevitable. However, if the challenges identified above can be effectively addressed through mutually acceptable solutions, long term welfare, structural and political benefits of China's GPA accession should be able to outweigh costs associated with those challenges. While GPA Parties may assist in such a cost-benefit analysis by providing detailed information on market opportunities and technical assistance, it is ultimately up to the domestic reformer leading the GPA accession negotiation to get the message across to national policy makers and domestic public and private suppliers. The adequate institutional framework for GPA accession negotiation is therefore of vital importance

### **III. The Way Forward**

GPA's approach to covered entities and procurement remains complex and lacking a general principle that facilitates the preparation of coverage offer by acceding countries. In the absence of general rules, the outcome of accession negotiation based upon reciprocity largely depends on the bargaining power of the acceding country and the expectation of existing Parties. Since the extent to which an acceding country can enjoy special treatment available for developing countries and retain existing discriminatory national policies by derogation is also subject to negotiation, the initial offer of coverage prepared by China has to be carefully calculated.

As the author has argued elsewhere<sup>41</sup>, the revised text (GPA 2007) has not addressed the fundamental problem of GPA coverage—lack of a principled approach. The exact scope of covered entities and covered procurement remains subject to negotiations on the basis of reciprocity, and further complicated by ambiguous provisions as well as diversified terminology and various types of derogation found in Parties' Annexes. That is why Chinese negotiators prepared the initial offer on covered entities and procurement in a gradual and cautious manner taking into consideration the balance between international obligation and domestic interests.

Linking China's GPA accession with other outstanding diplomatic and trade issues is arguably a "double edged sword". GPA Parties may assert more pressure by using political leverage at their disposal, such as the Tai Wan issue. However, Chinese government may become more defensive towards GPA accession due to such pressure and retaliate by delaying the negotiation against criticisms, such as those on China's human rights record.

More research is needed to systematically analyze the impact of China's GPA accession on both international and domestic regulation of government procurement. Although most challenges identified above could be addressed in the negotiation process through practical solutions or special arrangements, it is suggested a careful designed reform agenda with clearly defined objectives at both the

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<sup>41</sup>Wang, Ping "Coverage of the WTO's Agreement on Government Procurement: Challenges of Integrating China and other Countries with a Large State Sector into the Global Trading System" (2007)10(4) *Journal of International Economic Law* 887–920

international level and the domestic level should be the key. As the author has argued before, the GPA should endeavor to adopt a principled approach to coverage, to stop the practice of party-specific derogations and to revitalize the role of MFN in negotiation. Chinese authorities should further the domestic legal reform on public procurement aiming to unify and rationalize the existing regulations and policy-making process. However, such ideal solution will depend on the consensus of existing GPA Parties and the compromise of existing domestic stake-holders that are not easy to achieve.

On the other hand, it is also important to note the positive impacts of China's GPA accession from both international and domestic perspective. In facilitating liberalization of international public procurement market, China's GPA accession will symbolize the expansion of the GPA to the developing world and to a certain extent, help to attract more developing countries; it will reinforce the GPA's role as the leading WTO initiative for the liberalization of government procurement since other multilateral initiatives have made little or no progress; it will also encourage existing GPA Parties to move forward in optimizing current rules.

It can be argued that the challenges of China's GPA accession lies together with the opportunities provided. Only a thorough consideration of the proper approach based upon in-depth academic analysis will enable the policy-makers at both international and domestic level to maximize the benefit and minimize the cost.