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## The Limited Case for Permitting SME Procurement Preferences in the WTO Agreement on Government Procurement

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## Chapter XX

### **The Limited Case for Permitting SME Procurement Preferences in the WTO Agreement on Government Procurement**

*John Linarelli*\*

#### **1. Introduction**

Governments of countries with diverse levels of wealth, maintain preferential procurement policies to support small and medium sized enterprises (SMEs). The US is one of the most remarkable of examples. With billions of dollars annually set aside for contract awards made exclusively to what in the US are known as small business concerns, the US maintains some of the most extensive SME procurement preference policies that can be found anywhere in the world.<sup>1</sup> So much for all the rhetoric on Obama as socialist; these programmes have been in existence since 1953.<sup>2</sup> Irony is the notion that comes to mind when trying to understand the US approach, as the US also is able to liberalize substantial dollar values of its procurements as a contracting party to the World Trade Organisation (WTO) Agreement on Government Procurement (GPA) and in

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<sup>1</sup> The US Small Business Administration (SBA) 2009 publication, *The Small Business Economy: A Report to the President*, at pages 39-40, says:

‘Small businesses obtained \$83.3 billion in direct prime federal government contracts in FY 2007, according to the most recent data available. This figure amounts to 22 percent of the \$378.5 billion spent on federal procurement, and is up from \$77.7 billion spent with small firms in FY 2006. In addition to direct contracts, small businesses were awarded \$64 billion in subcontracts, for a total of more than \$147 billion in prime and subcontracting dollars. Despite the gains in dollar totals, federal agencies again missed the total procurement goal of 23 percent; the challenge to reach out to small business partners remains.’

<sup>2</sup> The US Small Business Act was enacted in 1953. 15 U.S.C. §§631-657o (citations omitted).

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unilateral and regional trade agreements. Other countries maintain preferential SME policies. South Africa maintains an evaluation preference system to award points to firms contributing to what is known as broad-based black empowerment in South Africa.<sup>3</sup> Notably, South Africa's programme is nowhere near as broad as the programmes found in the US. Some US programmes benefit firms owned by individuals who belong to historically disadvantaged groups in the US, but the US programmes also benefit ordinary SMEs, regardless of ownership. Malaysia maintains a substantial preference programme to award government contracts to people of Malay descent, the Bumipetera, who are the majority population in the country, to counter the market dominant Chinese minority in that country.<sup>4</sup>

The primary aim of this chapter is to put under scrutiny procurement policies designed to benefit SMEs *per se*, as small or medium sized enterprises, and to evaluate whether the GPA (and hence possibly other trade agreements liberalizing procurement markets) should accommodate these policies in some way, even though these policies might restrict international trade. The secondary aim of this chapter is to examine policies designed to benefit firms controlled by individuals who belong to a historically disadvantaged groups, and to evaluate whether the GPA should accommodate these policies. This chapter seeks to demonstrate that contrary to the standard argument that SME procurement policies are trade protectionist, there are cases in which they enhance competition and reduce procurement costs, though the conditions for these benefits are narrow and depend on proper institutional design.

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<sup>3</sup> [cite]

<sup>4</sup> C. McCrudden, *Buying Social Justice*, (Oxford University Press, 2007), pp. 73-5, 232-46.

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These conclusions on the economic merits of SME preference policies complement the noneconomic policy justifications for procurement preference policies to support firms owned and controlled by historically disadvantaged individuals, or HDIs.<sup>5</sup> Any agreement to liberalize procurement markets should deal with the reality that some states have longstanding policies in support of firms owned and controlled by historically disadvantaged individuals, rooted in the constitutional orders of those states. Substantial noneconomic rationales, grounded in notions of social justice and human rights, support these programmes, but the domain of these rationales as they are currently understood is limited to domestic societies. This limitation affects all negotiations to liberalize trade across national borders, in that states (or their leaders) do not hold the view that they have obligations to support the programmes of other states in the area of social justice. Social justice does not travel well across borders. All WTO members should have an equal opportunity to implement noneconomic policies having to do with promoting justice within their borders for their citizens. Governments are in fact required to pursue these policies and to the extent that governments cannot pursue them, then they will find the GPA a difficult agreement to join. Currently, only rich countries with large procurement markets can maintain SME and HDI procurement preference policies yet still benefit from GPA contracting party status. In its current state, the GPA, at least by default or implicitly, only gives powerful WTO members the ability to employ SME and HDI policies.

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<sup>5</sup> From here, the South African shorthand of 'HDI' will be adapted to refer to firms owned and controlled by historically disadvantaged individuals. Notably, proposed regulations in South Africa, if implemented, will change the terminology to one based on firms that contribute to 'broad-based black economic empowerment'. Draft Preferential Procurement Policy Regulations, 2009, 530 Government Gazette, No. 32489, 4 Aug. 2009. I am grateful to Phoebe Bolton for directing me to these regulations.

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Section 2 of this chapter sets forth the mixed economic justifications for preference policies in procurement that support SMEs *per se*. Section 3 elucidates the strong human rights and social justice justifications for preference policies that support firms owned and controlled by historically disadvantaged individuals. Section 4 explores how actual laws and policies play out at the international level, that is, how the GPA does not support procurement preference policies to support SMEs and HDIs. As Section 4 will explain, the accommodation of these policies comes in at the level of market power and not at the level of policy justification; those WTO members who cannot leverage their market power to keep some politically sensitive markets closed will not join the GPA and those that can leverage their market power in such way will join. Rationales for supporting SME and HDI policies converge at the international level. The GPA should accommodate SME and HDI policies for purposes of creating a level playing field between large market and small market WTO members. All WTO members should have an equal opportunity to pursue these policies in their procurement systems. Particularly as to procurement preference policies to benefit HDIs, the GPA should accommodate HDI friendly policies to respect values of social justice and human rights that well-ordered domestic societies are required to respect. The weakness of the GPA to accommodate SME and HDI policies likely offer clues why the GPA has had such trouble becoming multilateral. If ever there will be a need for revisions in a future GPA, these areas might prove to be productive places to focus.

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### **2. The Mixed Economic Justification for SME and HDI Preference Policies in Government Procurement**

Much has been written on how to improve the economic prospects for the SME sector, both from the perspective of the domestic economy and also in getting SMEs to be more effective in the international economy.<sup>6</sup> The question that seems to get sidestepped is why. Why should governments have special SME policies? Much of the literature focuses on the internal organisation or business aspects of SMEs, on how to make them more competitive or on how to make the public policy environment more conducive to their success. But an external argument that should interest social scientists and policymakers is why? Why should law and public policy allocate scarce resources to SMEs? Why not let the capital markets decide which businesses should succeed and which not? Why is government intervention beyond that of supporting efficient capital markets necessary to support SMEs? What sorts of benefits, welfare improvements (as normative welfare economists conceptualize this notion), wealth, well being, good, or just outcomes are promoted by government intervention to support SMEs specifically, apart from government support of the institutions for success of business generally?

The arguments for particular SME policies break out into two lines for our purposes: Why special SME policies in general and why special SME policies in the procurement area? This chapter can only provide a limited entry into the more recent inquiries in the

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<sup>6</sup> For a sampling only of recent OECD publications, see *The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses* (OECD 2009); *Removing Barriers to SME Access to International Markets* (OECD 2008); *Enhancing The Role of SMEs in Global Value Chains* (OECD 2008); *OECD Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes* (OECD 2007); *Enhancing SME Competitiveness: The OECD Ministerial Conference* (OECD 2001); see also K. Hallberg, *A Market-Oriented Strategy for Small and Medium Scale Enterprises*, International Finance Corporation Discussion Paper 40 (April 2000). There is a substantial literature, including an academic literature, beyond the scope of what can be cited here.

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field.

As for SME policies in general, recent literature suggests mixed results. Relatively recent empirical analyses by World Bank economists Thorsten Beck and Asli Demirguc-Kunt, along with Ross Levine and others cast doubt on a causal link between SMEs, economic development, and poverty alleviation. One of these studies finds strong positive association between SMEs and GDP per capita, but finds no confident predictions of a causal effect of SMEs on economic growth.<sup>7</sup> Moreover, SMEs were found not to alleviate poverty or decrease income inequality.<sup>8</sup> SMEs were found, however, to be more affected than large enterprises by the legal and institutional environment.<sup>9</sup>

Beck and Demirguc-Kunt summarize the pro and skeptical views on policy interventions for SMEs. Pro-SME interventionists rely on three main arguments. First, some pro-SME interventionists claim that SMEs ‘enhance competition and entrepreneurship and hence have external benefits for economy-wide efficiency, innovation, and aggregate productivity growth’.<sup>10</sup> Second, they often claim that SMEs are more productive than large enterprises but that capital markets and ‘institutional failures’ hinder their success.<sup>11</sup> Third, some claim that SMEs are more labour intensive and thus

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<sup>7</sup> T. Beck, A. Demirguc-Kunt and R. Levine, ‘SMEs Growth, and Poverty: Cross-Country Evidence’, *Journal of Economic Growth*, 10 (2005), 199.

<sup>8</sup> *Ibid.*

<sup>9</sup> M. Ayyagari, T. Beck and A. Demirguc-Kunt, ‘Small and Medium Sized Enterprises across the Globe’, *Small Business Economics*, 29 (2007), 415; T. Beck and A. Demirguc-Kunt, ‘Small and Medium Sized Enterprises: Access to Finance as a Growth Constraint’, *Journal of Banking and Finance*, 30 (2006), 2931; T. Beck, A. Demirguc-Kunt and V. Maksimovic, ‘Financial and Legal Constraints to Firm Growth: Does Size Matter’, *Journal of Finance*, 60 (2005), 137.

<sup>10</sup> Beck, Demirguc-Kunt and Levine, note 7 above.

<sup>11</sup> *Ibid.*

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are in a better position to alleviate poverty.<sup>12</sup>

The skeptics identify with four views. First, some stress the advantages of large enterprises.<sup>13</sup> Second, they often challenge assumptions relied upon in pro-arguments, such as that SMEs are more labour intensive.<sup>14</sup> Third, they express skepticism whether firm size has anything to do with economic growth.<sup>15</sup> This third argument is that factors such as natural resource endowments, technology, and institutions are the important variables for economic growth.<sup>16</sup> Fourth, some skeptics argue that what is most important for all firms, regardless of size, is business environment, and no need exists to subsidize SMEs.<sup>17</sup>

These studies do not evaluate the effects of SME preference policies in procurement. They do suggest, however, that a certain level of generality can be applied to their findings, though not without caution. The empirical work in procurement is limited, offers mixed results but also offers the potential for prescriptions on how to design preference policies to increase value for money for government. Justin Marion's empirical analyses of state of California government procurement indicates that a five percent bid preference resulted in 3.5 percent higher costs on California highway construction and that elimination of diversity subcontracting requirements resulted in a 5.6 percent decrease in procurement costs.<sup>18</sup> Thomas Denes' empirical analysis of US

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<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

<sup>18</sup> J. Marion, 'How Costly is Affirmative Action: Government Contracting and California's Proposition 209', *Review of Economics and Statistics*, 91 (2009), 503; J. Marion, 'Affirmative Action and the Utilization of Minority- and Women-Owned Businesses in Highway Procurement', (2009); J. Marion,



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Army Corps of Engineers dredging procurements in 1990-1991 finds that in all but one instance, no significant difference existed between bids submitted on small business set-asides and those submitted on unrestricted procurements subject to full and open competition.<sup>19</sup>

A very recent and as yet unpublished study of small business set-asides in Japanese government procurement in construction advises that the exit of small business firms if set-asides were removed would increase procurement costs.<sup>20</sup> While these findings are still very new and more research needs to be done, they do suggest a game theoretic insight about the design of procurement markets, which may result in increased competition and decreased procurement costs. Consider the work of Ian Ayres and Peter Cramton on affirmative action in US Federal Communications Commission (FCC) auctions of paging (regional narrowband) licenses. In these auctions (sales), the FCC grants a forty percent preference on ten of the thirty licenses to firms owned by historically disadvantaged individuals, and a subsidy for interest payments.<sup>21</sup> Ayres and Comton found these preferences actually increased competition and generated an additional \$45 million in revenue for the government.<sup>22</sup> The bidder preference caused bidders to bid more aggressively in an attempt to win the auctions. Some room for

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'Costs and Benefits of Affirmative Action in California Government Contracting, - Executive Summary' (May 1, 2005); available at SSRN: <http://ssrn.com/abstract=1367887>; J. Marion, 'Are Bid Preferences Benign? The Effect of Small Business Subsidies in Highway Procurement Auctions', *Journal of Public Economics*, 91 (2007), 1591.

<sup>19</sup> T. A. Denes, 'Do Small Business Set-Asides Increase the Cost of Government Contracting?', *Public Administration Review*, 57 (1997), 441.

<sup>20</sup> J. Nakabayashi, 'Small Business Set-Asides in Procurement Auctions: An Empirical Analysis', University of Tsukuba Economics Working Paper Series No. 2009-005 (Nov. 2009).

<sup>21</sup> I. Ayres and P. Cramton, 'Deficit Reduction Through Diversity: How Affirmative Action at the FCC Increased Auction Competition', *Stanford Law Review*, 48 (1996), 761.

<sup>22</sup> *Ibid.*

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optimism thus exists to support the notion that procurement preference policies, properly designed, can serve the goals of supporting SMEs and a fair distribution of government contracts to them while also promoting value for money in procurement.

The emphasis should be on careful design. The Ayres and Comton study supports bidder preferences in procurement open to all, and not set-asides, as set-asides by their very nature cannot increase competition. The International Trade Centre (UNCTAD/WTO) publication, *SME and Export-Led Growth: Are they Roles for Public Procurement Programmes*, published in 2000, expressed some worry about the efficacy and efficiency of set-asides.<sup>23</sup> All of these sources, and other empirical work that should be done, might advise us that an economic justification indeed exists for some properly designed procurement preference policies to support SMEs.

But we should also not forget the noneconomic justifications even for policies that support SMES *per se*.<sup>24</sup> The U.S. Small Business Act states that it ‘is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including but not limited to contracts or subcontracts for maintenance, repair, and construction) be placed with small business enterprises . . . ’.<sup>25</sup> It just might be that governments and their citizens prefer, to what might be American vernacular, ‘the little guy’, who might be seen as including

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<sup>23</sup> *SME and Export-Led Growth: Are There Roles for Public Procurement Programmes?* (ITC UNCTAD/WTO 2000).

<sup>24</sup> Section 3 below explains the noneconomic justifications for procurement preference policies supporting HDIs.

<sup>25</sup> 15 U.S.C. §631.

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some of the lesser off in society, for a fair allocation of government contracts. This can be conceptualized positively as a preference to assist the less well-off in society, rather than negatively as dividing the spoils of government largess.

### **3. The Social Justice and Human Rights Justifications for HDI Preference Policies in Government Procurement**

While economic analysis provides methods for understanding the efficacy of the procurement preference policies designed to assist HDIs, economics cannot help us identify the values that support them. Economics is helpful in understanding the effects - the empirical aspects - of these policies, but not in understanding the reasons why these policies are important and necessary in many countries. Those reasons are grounded in notions of social justice and human rights. Two examples may be offered, that of South Africa and the US. The Bolton and Quinot chapter explains the constitutional foundations of South African HDI preference policies. US HDI policies are constitutionally protected under the equal protection clause of the US Constitution, though the US Supreme Court has narrowed the parameters of that protection in recent years.<sup>26</sup>

Christopher McCrudden's book, *Buying Social Justice*, is a canonical account of HDI procurement preference policies.<sup>27</sup> This chapter will not rework the institutional detail McCrudden admirably explicates. The aim here is to identify the justification for these policies, in a way that makes clear that they do not need an economic justification, and that the noneconomic justification is compelling.

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<sup>26</sup> L. R. Zehrt, 'A Decade Later: *Adarand* and *Croson* and the Status of Minority Preferences in Government Contracting', *National Black Law Journal*, 21 (2009), 1.

<sup>27</sup> McCrudden, *Equality and Social Justice*, (Oxford University Press, 2007).

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Here is a way to ground the justification for HDI preference policies. The notions to follow may be said to serve as basic principles underlying a just constitutional order. How certain important goods, usually income, wealth, powers, opportunities, rights, the bases of self-respect, and so on,<sup>28</sup> are distributed in a society is a matter of justice, not efficiency or power. As a matter of justice, the fair distribution of social goods is nonnegotiable. It is a duty that governments are required to respect.

Distributive justice is about fair terms of social cooperation in a society. Distributive justice policies often support preferential policies for the poor, for the worst off, for the underprivileged, and for those who belong to identity groups that have suffered longstanding discrimination and exclusion. For a distribution to be just, it should not make less well off persons even less well-off while making richer people better off.<sup>29</sup> We may also add to the discussion the concept of luck egalitarianism, in that people should suffer the consequences of choice, not circumstances, and that belonging to an identity group disfavored (wrongly or unjustly) by society is something that should not lead to diminished life opportunities for affected persons.<sup>30</sup> Finally, distributive justice is a moral notion that applies to institutions; we can expect individuals and firms to operate as ordinary self-interested economic agents in society, but within the constraints, imposed by institutions (such as public procurement law), whose policies and operations are required to comply with the demands of distributive justice.

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<sup>28</sup> These are based on John Rawls' notion of primary social goods. J. Rawls, *A Theory of Justice*, (Cambridge MA: Harvard University Press, 1999).

<sup>29</sup> This proposition reflects and generalizes John Rawls' famous difference principle. J. Rawls, see note 28 above.

<sup>30</sup> There is a substantial literature on theories of justice that cannot possibly be replicated here. One can start with John Rawls, *A Theory of Justice*, published in 1972; perhaps the most important book of the twentieth century in moral and political philosophy, and work from there.

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Distributive justice and economic efficiency may work at cross-purposes. A social arrangement may be efficient and yet fundamentally unjust. Let us assume that governments only focus their attention on transaction costs and reducing barriers to entry in government procurement. Facilitating the operation of markets in government procurement does not ‘guarantee’ fair participation in those markets by SMEs and HDIs. It might be efficient to only have large multinational enterprises, who have the benefits of economies of scale and low cost global supply chains, provide bundled goods and services to government, regardless of the national origins of these goods and services, and regardless of the working conditions or wages paid for these goods and services to labour, regardless of ownership of these firms, and so on. Governments, however have duties that go beyond efficiency in procurement.<sup>31</sup> They have duties of justice. While all social institutions are required to meet the demands of justice, a government as a buyer is in a special role to promote justice; it is now well accepted that governments can and do use procurement as a social policy tool.<sup>32</sup>

So far, what has been provided is the ‘good’ story about HDI preferences.<sup>33</sup> These preferences promote social justice for disadvantaged groups. In some countries, they are intended to mitigate historic injustice, situations in which past policies made favored groups better off while making disfavored groups worse off. They are policies of repair. But political economists might give us a different interpretation. The ‘bad’ story about

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<sup>31</sup> See, e.g., S. Arrowsmith, ‘Public Procurement as a Tool of Policy and the Impact of Market Liberalization’, *Law Quarterly Review*, 111 (1995), 235.

<sup>32</sup> Ibid.

<sup>33</sup> What follows is from J. Linarelli, ‘The WTO Agreement on Government Procurement and the UNCITRAL Model Law: A View from Outside the Region’, *Asian Journal of WTO and International Health Law and Policy*, 1 (2006), 317.

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preferences, one that we would find in the political economy or public choice literature, is that they are wasteful and in some cases unjust. The bad story is that some governments have used public procurement as an enclave in which politics predominates over market-based considerations, to protect favored industries or even to dispense patronage to political friends. In the worst case, corruption diverts scarce public resources to socially wasteful contracts. The result is the typical litany of public policy ills, ‘corruption, inefficiency, political capture, rent seeking, protectionism, inflated costs, and the development of cartels’.<sup>34</sup> Interest groups are cast in a negative light.<sup>35</sup>

The ‘good’ and the ‘bad’ stories are difficult to reconcile. Theories of justice are stated in ideal and normative terms, in concepts of the duties that governments implement for their citizens in a well-ordered society. The theories of political economy are predictive social science theories; they attempt to predict or describe how people actually behave. These two accounts do not have to conflict. While governments may have duties to achieve justice, they must operate in a world in which people behave in their self-interest. But that policies are prone to these difficulties does not mean that governments should fail to strive to achieve just policy outcomes. Oliver Wendell Holmes might be right that law is for regulating the ‘bad man’,<sup>36</sup> but we want that regulation to be just.

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<sup>34</sup> C. McCrudden and S. G. Gross, ‘WTO Government Procurement Rules and the Local Dynamics of Procurement Policies: A Malaysian Case Study’, *European Journal of International Law*, 17 (2006), 151 at 153-54.

<sup>35</sup> J. Linarelli, Note 33 above; J. Linarelli, ‘The WTO Transparency Agenda: Law, Economics and International Relations Theory’, in S. Arrowsmith and M. Trybus (eds.), *Public Procurement: The Continuing Revolution*, (The Hague: Kluwer Law International 2003), p. 256.

<sup>36</sup> O. W. Holmes, ‘The Path of the Law’, *Harvard Law Review*, 10 (1897), 457.

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### **4. The GPA on SME and HDI Preference Policies**

The GPA nonmarket access provisions do not permit SME or HDI preference policies. Going further, SME preference policies probably violate several GPA provisions.

SME and HDI preference policies likely violate the national treatment and non-discrimination provisions found in GPA Article III, though the argument could be made that national treatment obligations actually are complied with, because both domestic and foreign suppliers who are not eligible for a preference are treated the same. Having said that, domestic suppliers may have the opportunity to comply, whereas foreign suppliers do not. For example, for the US small business and minority set aside programmes, a ‘small business concern’ as defined by US Small Business Administration Regulations and the US Federal Acquisition Regulation (FAR), is a domestic concern that meets what are known as size standards. The SBA regulations provide:

‘a business concern eligible for assistance from SBA as a small business is a business entity organized for profit, with a place of business located in the United States, and which operates primarily within the United States or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor’.<sup>37</sup>

Some firms plan around staying small in order to continue to qualify for these set-asides. But a pre-condition for such planning is in meeting this nationality requirement for small business concerns.

SME and HDI preference policies violate the tendering procedures set forth in GPA Articles VII through XVI. Article VIII(b), on qualification of suppliers, provides that

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<sup>37</sup> 13 C.F.R. §121.105(a)(1).

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‘any conditions for participation in tendering procedures shall be limited to those which are essential to ensure the firm’s capability to fulfil the contract in question’. GPA Article X selective tendering procedures and Article XV limited tendering procedures mandate nondiscrimination as between domestic and foreign suppliers.

Finally, GPA Article XVI severely restricts offsets and could be said to prohibit many SME preference policies. Article XVI(1) prohibits offsets ‘in the qualification and selection of suppliers . . . or in the evaluation of tenders and awards of contracts . . .’. Footnote 7 to the GPA defines offsets as ‘measures used to encourage local development . . . by means of domestic content . . . investment requirements . . . or similar requirements’.<sup>38</sup>

These provisions, however, are not definitive as to the permissibility of SME preference programmes under the GPA. The approach the GPA contracting parties have taken is to negotiate exceptions from GPA coverage in their market access provisions of the GPA, i.e., in the annexes. Korea, Japan, and the US have negotiated such provisions. They all maintain small business set asides while the US also maintains various programmes to assist small minority firms as well.<sup>39</sup> As McCrudden explains, the EU opposed these exemptions and included in its annexes a provision rejecting the availability of bid challenge remedies under GPA Article XX to suppliers of Korea, Japan, and the US to challenge contract awards to SMEs under EC law.<sup>40</sup> Interestingly, EC policy is to oppose set-asides and other procurement preferences for SMEs only.<sup>41</sup>

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<sup>38</sup> For more discussion, see McCrudden, note 4 above, pp. 231-32.

<sup>39</sup> *Ibid.*, pp. 211-30.

<sup>40</sup> *Ibid.*, p.219.

<sup>41</sup> See, e.g., *Communication from the Commission to the Council, The European Parliament, the European*



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Switzerland, Lichtenstein, Iceland and Norway included a similar provision in their annexes.<sup>42</sup>

NAFTA and various bilateral and regional agreements with which the US is a party maintain similar exemptions for SME preferences. Notably, other countries exempt various SME and socioeconomic programmes from the reach of the liberalization provisions of these agreements, in what McCrudden calls a move toward ‘social globalization’.<sup>43</sup>

These moves illustrate a basic tension between social justice ideals and the reality that no global conception of justice is at work. As explained in the preceding section, justice is mainly a domestic matter. Justice is a duty governments owe to their own citizens. Noneconomic policy rationales have no standing in WTO agreements. WTO members (and GPA contracting parties) bear no duties to protect vulnerable groups in the societies of *other* WTO members. They instead insist on market liberalization and conceptualize SME policies as protectionist, even if they are designed to protect or promote the rights of the historically disadvantaged in the domestic societies of other WTO members. They interpret these policies as falling within the ‘bad’ story of protectionism. What is one WTO member's social justice is another's protectionism. WTO members have no obligations to accept one another's social justice policies.

This tension offers a possible explanation, or at least a possible partial explanation, why the GPA is limited in membership and remains plurilateral. WTO members cannot

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*Economic and Social Committee and the Committee of the Regions*, “‘Think Small First’; A “Small Business Act” for Europe’, COM(2008) 394 final.

<sup>42</sup> McCrudden, note 4 above, p. 219.

<sup>43</sup> *Ibid.*, p. 223-25.

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become GPA contracting parties unless they can use their procurement market power to negotiate a deal that permits them to maintain SME and HDI policies while still liberalizing substantial procurement markets. Few countries can do this. Indeed, the tension is fundamental, if one accepts the notion that governments are *required* to ensure that the institutions affecting the lives of their citizens are just.

One way of extending the GPA into the ‘good’ story sketched in the preceding section is to argue that the GPA market access provisions promote fairness to the extent that they give GPA contracting parties the ability to promote social justice and to intermediate the effects of globalization on public procurement markets, and to the extent that some level of protection forms part of a legitimate political consensus within the constitutional systems of GPA contracting parties who choose to follow such a route. So, if a GPA contracting party maintains a policy of repair to remedy past actual or societal discrimination in government procurement (or in society generally) against certain groups, or simply to favor SMEs, then it can withhold market access for some procurements designated for these groups, by not putting those procurements on the table for coverage by the GPA. Thus, in contrast to the close connection of GPA non-market provisions to economic efficiency, value for money and trade liberalization in public procurement, the market access provisions give the GPA contracting parties ‘outs’ by converting the GPA into an umbrella arrangement for a series of negotiated arrangements liberalizing only those markets the WTO members could liberalize without running afoul of principles of justice and other noneconomic policies that are important in their domestic constitutional orders. The non-market access provisions are subservient to the

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market access provisions; they apply only to procurements liberalized in the annexes.

But we must remain skeptical that bargaining GPA market access can do the job. Power, and not justice, is still in play at the WTO level. The GPA market access provisions permit the implementation of domestic justice policies imperfectly and incompletely. The GPA market access provisions allow GPA contracting parties to keep domestic preferences, provided they can liberalize sufficient numbers and values of other procurements. The US does this; it opens up substantial procurement markets yet also keeps substantial procurement markets closed, in order to maintain its substantial preference programmes. But here lies the potential problem. The extent of a GPA contracting party's autonomy to pursue its own domestic justice policies depends on its market power, on its ability to offer up on the GPA negotiating table substantial other procurements unaffected by preference programmes. Thus, in the GPA context, only contracting parties with substantial import markets in public procurement have substantial policy autonomy. In the end, justice is subservient to market power. And only so many WTO members have the market power to provide these sorts of benefits.

If WTO members do not like these results, the GPA should change. One way to accomplish the change is through a synthetic approach, balancing procurement market liberalization with sensitivity to the demands of justice within states. In a future negotiating round, the GPA could be amended to permit SME preference policies that do not unduly restrict international trade in government procurement. This synthesis is suggested by Ethan Kapstein's 'level playing field' approach to understanding the normative principles that should apply to international trade agreements. Kapstein notes

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that the GATT's preamble states that countries will achieve trade liberalization 'by entering into reciprocal *and mutually advantageous* arrangements'.<sup>44</sup> Kapstein continues:

'However, reciprocity qua equivalent exchange cannot be seen as the basis for an international trade regime that is viewed by each participant as mutually advantageous or fair. Instead, the reciprocity principle has to be "diffuse" or "relaxed", recognizing the relative bargaining power of the economy in question. The concept of reciprocity in the context of the trade regime must therefore be sensitive to the requirements of the "least advantaged" states: those lacking the human, natural, or financial resources necessary for carving out their place in the division of labor. Justice as fairness demands that their needs be met'.<sup>45</sup>

Kapstein's diffuse reciprocity idea is a way to justify a balance in which WTO members get policy space reserved for domestic issues yet have the capacity to join a GPA that promotes market liberalization. For example, following up on research by Ayres and Cramton, discussed in the preceding section, properly constructed evaluation preferences might actually increase competition. SME and HDI preference policies actually might not be protectionist in every case. It would be impossible to say that increased competition will occur in every procurement; it depends on the extent of competition and how lucrative the procurement in question will be for particular firms. The basic point is, however, that such policies should not be dismissed out of hand. If the WTO does not get creative on the social end of globalization, bilateral and regional

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<sup>44</sup> E. B. Kapstein, *Economic Justice in an Unfair World: Toward a Level Playing Field*, (Princeton University Press, 2006), p. 60.

<sup>45</sup> *Ibid.*

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agreements that do will become increasingly dominant. Of course, the WTO Subsidies and Countervailing Measures Agreement would have to accommodate SME policies as well, in any such reworking of the GPA, as SME and HDI preferences may be unlawful subsidies under that Agreement.

### **5. Conclusion**

SME and HDI preference policies in public procurement have long been considered to be in basic tension with the notion of procurement liberalization. The GPA has only accommodated these tensions for countries with the ability to open substantial procurement markets through the GPA market access provisions. It is now time to give smaller states equivalent negotiating leverage. The GPA should go in two directions. First, WTO members should be cautious in any future revision of the GPA to only permit procurement preference policies for SMEs and HDIs that have the real potential to liberalize markets and reduce costs for procuring entities. This first recommendation requires sustained study of what works and what does not work. Second, the GPA should be revised to place all WTO members on an equal footing in being able to implement their duties of justice to their citizens through procurement. SME and HDI policies should be equitable not only at the national level but also at the international level. To not reconcile this problem of justice at both the national and international level is to invite continued controversy over the GPA. Some negotiating room certainly must come to exist for SME and HDI policies, which need not be the sort of exclusionary set-aside policies that the US has used. Evaluation preferences may be as effective at promoting

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justice and other noneconomic values while still maintaining competition in government procurement.