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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

**Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE
COUNCIL**

**establishing rules on the access of third country goods and services to the European
Union's internal market in public procurement and procedures supporting negotiations
on access of European Union goods and services to the public procurement markets of
third countries**

Annex

{COM(2012) 124 final}
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ANNEX 4

ANALYSIS OF IMPACTS

1. Methodological crosscutting issues¹

IMPORTANT: Methodological issues regarding calculations of impacts on leverage, EU trade and jobs are clarified in Annex 7

1.1 - Procurement rules of origin for services procurement contracts²

Rules of origin to be developed for a legislative instrument would have a significant impact on the reach of potential restrictive measures.

- If rules of origin would adopt a broad definition of EU services suppliers, based on the justification of a registered office within the EU for instance, and exclude only companies established in jurisdictions other than the territory of the EU MS, without any branch in the EU, restrictive measures would impact only direct cross-border procurement operations. In 2007, such procurement flows represented 200 million EUR of contracts, hence 0,05% of the whole public procurement market.

- Conversely, definition of EU service suppliers cumulating criteria based on establishment and ownership or control would impact a wide range of procurement within the EU, since branches of foreign companies established in the EU would be assimilated to non EU companies despite the fact that these branches have de facto a substantial link with the EU economy. As a consequence, it would certainly disturb foreign direct investment flows, especially when they are designed to have access to EU procurement markets and related jobs. (e.g. if a Chinese company takes over a French company, the latter would lose the right to participate in a tendering procedure)

- Finally, identification of EU service providers based on a substantial link to the EU economy without requirements in terms of ownership or control would produce a medium effect on procurement flows. Indeed, restrictive measures would certainly target "letter box" companies – companies in a position to justify a registered office in the EU but with the only purpose to ease provision of services abroad - but would not impact subsidiaries of non EU companies in one or several MS.

In addition, the definition of rules of origin for service providers raises the issue of the regime applicable to consortium or other bidding partnerships made of EU companies and foreign business as well as the treatment of franchises. The definition to be chosen has to comply with EU international obligations under the GATS, GPA and FTAs (non discrimination between single bidders and

¹ Due to methodology considerations, this analysis focuses on the statistic effects (and not on the dynamic effects) of the assessed impacts. The focus of the analysis is also on the effects on direct procurement related trade.

² For more details, please check methodological note D in annex to this impact assessment

consortium). These rules would in any case impact the access for the biggest procurement contracts, especially in the field of construction services. In these sectors, most public private partnerships are awarded to international consortiums, possibly including non EU companies.

1.2 - Assumptions of the impact assessment analysis - market behaviour

Public procurement is a market where contracting authorities buy from businesses. As in all markets, each of the players have specific incentives.

In this context, based on the analysis made for the evaluation of public procurement procedures³, the main incentives of contracting authorities (based on the evaluation of directives - PwC study) are:

- Lowest possible risk of litigation (as it delays the procedure).
- Efficient purchase (good quality/price ratio).
- Time.

Purchasing decisions are decentralised and contracting authorities can be considered to be single units that, unless instructed, do not necessarily wish to take industrial policy into consideration.

There are however some caveats:

- Central government authorities can be assumed to follow prescriptions of industrial policy.
- Local governments may want to protect local jobs.

Finally, businesses are assumed to be always interested to participate in public procurement (cf. methodological box 1 in impact analysis).

1.3 - Assumptions of the impact assessment analysis -Responses by trading partners

1.3.1 - Incentives to negotiate - the so-called "negotiations leverage"

Third countries shall be considered keen to re-negotiate with the EU insofar the markets matching their offensive interests are closed domestically (i.e. through EU legislation reflecting EU's international commitments).

In this context, the mere existence of a 'threat' of closure through restrictions that can be applied **optionally** (options 2, 3A, 3B1, 3C and 4) or **selectively** (option 3B2) by EU contracting authorities will lead third countries to consider that there is a risk that at any moment the instrument can be applied systematically.

For instance, a country like Japan would still wish to obtain access to the EU railway procurement market - which is not covered - even if the instrument would not systematically close that market.

³ Public Procurement in Europe: cost and effectiveness, PwC-Ecorys-London Economics (2011), study performed in the context of the evaluation of public procurement directives.

Incentives to negotiate - or the so-called "negotiations leverage"- will depend on the size of untapped exports by each negotiations partner. It is therefore measured through the leverage index (cf. Annex 5).

Protectionist hysteresis

If, due to internal pressures by domestic industries willing to benefit from a rent effect, a country is not likely to offer market access commitments on markets closed based on a internal legislation, its capacity to obtain equivalent opening in foreign markets is deeply affected. Therefore, the analysis of leverage should take into account the dynamics of domestic protectionist pressures. Such an assessment is based on the economic framework for "protectionist hysteresis".

The analysis of leverage also has to reflect how potential restrictive measures impose to renegotiate the access to markets *priori de facto* open before the intervention of restrictions and countermeasures.

This phenomenon is proportionate to the degree of closure resulting from each option.

1.3.2 - Assumptions on scope and scale of retaliation

Predicting reactions by trading partners is a **difficult** and **subjective** prospective exercise. If the proposed instrument hits trading partners' offensive interests, then they might be inclined to negotiate. But, they can also be tempted to opt for retaliatory measures.

The dynamics of retaliation is rather complex.

First, resorting to retaliatory measures is a difficult decision to take. . All trading partners benefit from open trade and, more importantly, they also depend on the supply of specific products from Europe. It is therefore unclear whether affected trading partners will decide to retaliate against the EU.

Secondly, retaliatory measures can take various forms:

(a) Retaliatory measures specifically targeting the EU, or alternatively, all trading partners alike. (b) Retaliatory measures in the area of procurement and/or in other trade areas:

- Restrictive countermeasures could be imposed or reinforced⁴ on procurement not committed internationally so far left open on the basis of a domestic legislation not limiting the opening of these sectors.

- Imposing tariff and non-tariff countermeasures in response to restrictive measures applicable only to procurement. Most of the emerging economies have

⁴ China already did so in 2007-2008 to accompany its stimulus package: a set of circulars recall central and local governmental entities their obligation to strictly apply the Buy Chinese requirements under the Government Procurement law

kept flexibility on tariff rising (with the notable exception of China)⁵, but objective constraints might however limit the use of tariff-based retaliations⁶. As a result, it cannot be excluded that some trading partners could eventually resort to non-tariff barriers such as administrative requirements, technical barriers or SPS regulatory obstacles for instance

In this context, 3 scenarios have been envisaged in terms of retaliation by trading partners:

(a) No retaliation - none of the trading partners takes measures restricting exports of EU goods and services to their procurement market.

(b) Simple retaliation or retaliation at the same scale⁷- the trading partners that have not enacted crosscutting retaliatory measures like India and Australia introduce such measures and Turkey reinforces its existing measures.

(c) Boycott - trading partners close completely their public procurement open domestically but not committed internationally, to "boycott" EU goods and services.

The most likely of all retaliation scenarios is the "simple retaliation". Not considering any retaliation would be too a optimistic approach (and wouldn't make this impact assessment sufficiently precautionous), whereas a "boycott" scenario is by far too pessimistic (trading partners also need open trade, trading partners that maintain protectionist measures lack arguments to retaliate, trading partners may find less costly to negotiate than to retaliate and trading partners may be bound within pre-existing agreements).

Still, the scenarios "no retaliation" and "boycott" will be used as boundaries to measure costs and benefits of each of the envisaged options.

1.4 - Scope of administrative burden

All options foresee two flows of information obligations:

- **Notifications by contracting authorities to the Commission**
- **Determination of the procurements rules of origin (PROs)**

Notification

Two scenarios are possible:

- The notification is an official document sent to the Commission

⁵ Brazil, Russia and India dispose of a room of manoeuvre to raise applied tariffs to the level of bound tariff. China is however an important counterexample since its WTO accession protocol includes a commitment to match bound and applied tariffs

⁶ Since the MFN requirements under GATT and GATS impose a rule not to target a specific WTO member and to extend any tariff rising to all parties, EU trading partners would have no choice to make a protectionist shift exceeding from far the initial restriction on procurement markets limited to the EU jurisdiction.

⁷ The effective extent of retaliation will depend in the end on their own perception of the reach of EU restrictions

- The notification is made through existing information obligations such as prior information notices, contract notices and/or contract award notices.

The administrative burden is minimised in our view through the use of existing information obligation.

Determination of PRO

Determining the PRO is a complex exercise because rules of origin are *per se* complex.

Two scenarios are then possible:

- The task falls on the contracting authority, which might be short of internal resources to proceed and might consequently revert to external assistance in the public sphere (MS national custom authorities) or on the private market (custom brokers, consultants, lawyers...)
- The task falls on the bidder itself, who is required to produce a certificate to define/prove its PRO (certificate of origin or equivalent document)

The risk of errors will be minimised if the task falls on the bidder, who has all incentives to participate in the bid, rather than in the contracting authorities that are risk adverse to litigation and lack the whole expertise in terms of rules of origin. This is especially important under 3 A where procuring entities have incentives to apply restrictions and, therefore, would be faced with litigation risks if they commit a misinterpretation of PROs.

In addition, the review by the Commission implies the following burden:

- Proceeding the review and preparing the decision of the Commission for Commission services
- Cost of opportunity for procuring entities that would have to delay the launch of the tendering procedure or would face interference between the review procedure and the tendering procedure (depending on notification and review modalities).

1.5 - Overall impact on innovation

In general, measures imposing limitation on the competition pressure in the EU public procurement markets will reduce incentive for bidders to innovate. The relationship between market contestability and incentive to innovate (or adopt innovation) is well developed in economic theory.

However, given the pre-existing level of competition within the EU internal procurement market (5 bids for each tendering procedure), the negative impact of restrictive measures on innovation might be of a reduced scale, except for goods and services' markets where there is almost an oligopolistic situation (3 bids or less eg pharmaceutical products, medical equipment, maintenance services, tyres, energy). As a result, the impact on innovation has to be assessed in the light of sectors subject to restriction under each option.

1.6 - Overall impact on SMEs

The Opinion of the Economic and Social Committee (2010) on the internationalisation of SMEs, the OECD Athens Action Plan for SME and the publication of the Observatory of EU SMEs identify the following main obstacles to the internationalisation of SMEs:

- Lack of support or advice from national administrations, or even to identify existing support mechanisms.
- Export difficulties caused by foreign legislations
- Problems to identify potential clients
- Problem to set up a subsidiary abroad
- Lack of financing (to invest in market access)
- Anti-competitive practices of local authorities and businesses

They also propose the following recommendations:

- Open up foreign markets through negotiations
- Limit the use of trade defence instruments by third countries
- Promote the respect of EU norms and quality requirements
- Improve trade defence instruments in favour of SMEs
- Ease the administrative support to SMEs

In this context, the main potential impacts of this instrument will be to open markets and offer the possibility to use trade defence mechanisms. At the same time, it will be important to protect SMEs against retaliatory measures.

Gains on access to foreign procurement markets are likely to benefit EU SME at the scale of their share in EU exports (taking into account both direct award of procurement contracts and participation in the performance of procurement contracts via subcontracting).

Given establishment barriers met by SME on foreign markets compared with large-scale companies, they should even take a bigger advantage of the increase of direct cross-border procurement. As language and distance play a great role in direct cross-border procurement, any gain in market access is likely to be positive for :

- UK and Irish SMEs in US, Canada, India and Australia.
- Portuguese and Spanish SMEs in Latin America.
- French and Belgian SMEs in Canada.
- Bulgarian, Greek SMEs in Turkey.
- Bulgarian, Estonian, Latvian and Lithuanian SMEs in Russia.
- Polish SMEs in Ukraine and Russia.

The benefit will be therefore proportionate to the value of these procurement markets for each MS companies.

1.7 - Impact on employment

The impact on employment is derived from the additional exports and reduced imports (through retaliation). Annex 7 provides more detail on how to link impacts on exports and imports, on the one hand, and impacts on jobs in the EU.

1.8 - Overall environmental impact

Measures imposing barriers to foreign goods and services' access to EU markets may indeed undermine the incentive of foreign firms to adopt stricter environmental standards used by EU firms. Given the large size of the EU procurement market, this can eventually slow down the shift of foreign firms towards the adoption of less polluting techniques and the production of environmentally friendly goods and services.

2. Baseline scenario and option 2B (reinforcement of trade negotiations)

The baseline scenario shows how the problems described in the problem definition will most likely evolve without any further action by the EU. Under this scenario:

EU public procurement legal framework

- The present legal framework remains in place (Article 58 of Directive 2004/17)
- The proposed Public Procurement directives are adopted with provisions on production processes and on life-cycle cost in selection/awarding criteria
- The proposed Public Procurement directives extend the scope of public procurement that can be committed internationally to all services (except social services) and to service concessions

On-going negotiations and non-EU legislations

- The EU continues to negotiate bilaterally with the US and Japan (railways)
- The EU continues to negotiate the accession of China to the GPA
- The FTA with Ukraine enters into force
- The EU continues to negotiate the FTAs with India, ASEAN, Canada, Mercosur,...

TRADE : see comments on the relevant chapter

In terms of **improvement of the access to third countries procurement markets** through existing negotiations, a *pessimistic scenario* and an *optimistic scenario* shall be analysed. In both scenarios, the results achieved so far with in GPA (opening of Korean railways market, opening of Japanese public private partnerships and progressive lifting of offsets in Israel) and full opening of Canadian procurement market can be reached. It is nevertheless very difficult to predict under which conditions China or Russia shall accede to GPA, how the US will conduct its bilateral procurement negotiations and whether the EU will start procurement negotiations with Turkey, Australia, South Africa and ASEAN nations (but Singapore and Malaysia).

Under a *pessimistic scenario*, it cannot be excluded that (1) bilateral trade negotiations with India or Mercosur are never concluded (eventually for other reasons than procurement) and (2) bilateral trade negotiations with Japan are never started.

Under an *optimistic scenario*, it can be expected that: (1) India and Brazil (Mercosur) commit their central government procurement (including railways in India and power generation in Brazil) and (2) Japan engages a effective market opening in the railways sector (as prepared by the GPA side agreements and to undertake further market access commitments on local procurement in the context of a possible FTA

The **implementation problems** will not significantly change - and actually could worsen - as additional Member States will be tempted to take domestic measures, in disregard of the EU's exclusive competence of common commercial policy. As indicated earlier, this could lead the EU to face panels and ultimately undermine the credibility of the EU in international procurement negotiations. Alternatively, the Commission may have to take member States to the ECJ for infringing on the exclusive competence of the EU for the common commercial policy, but this would increase the perception of openness of the EU precisely at a moment when the EU is lacking leverage.

2.1 - Impact on trade flows

Effects of national policies conducted by Member States

Due to the lack of clarity of the rules of origin for services applicable and goods in procurement (hereby referred to as "procurement rules of origin"-PROs), Member States already act and may continue to act in an inconsistent manner affecting trade flows with foreign countries.

Some Member States could, for example, decide to target third countries' goods and service themselves, while others might prefer to restrict access to firms based in a third country, if not the subsidiary of a firm headquartered in a third country or even a company which lacks experience in the EU. Member States could also contemplate to include franchises or apply restrictions only in those sectors that matter for them (e.g. if dredging is important for Belgium, it may only apply restrictions in that field).

On this basis of existing practices, Member States, which are specialised in sectors, which depend on public procurement, could also be tempted to take national measures to regulate access of third countries firms, goods and services in their own public procurement market, in spite of the fact that this would be in breach of the Treaty.

Autonomous protectionist tendencies by trading partners:

As regards the existing de facto market access, the aftermath of the financial crisis in 2008 and its aftershocks do not suggest that the major economies in the world are tempted to lift their existing restrictive measures in national law, quite on the contrary. In this context, **the remaining 11% of public procurement markets that are not committed internationally but are not open de facto may shrink over time.**

Moreover, it cannot be excluded that financial resources by States and state-owned companies will be devoted to foster industrial policy mainly based on the development of national champions.

Retaliatory actions by trading partners

It is difficult to predict the retaliatory actions from trading partners. As a result, we shall analyse 3 types of retaliation scenarios:

- 'No retaliation' scenario: trading partners don't retaliate

- 'Simple Retaliation' scenario where only those countries that have not enacted protectionist measures (India and Australia) or that do not apply them systematically (Turkey) actually take measures to block the access from EU suppliers and service providers in the same proportion as the EU; GPA Parties would not take any measures, since they have already agreed with the EU which parts of their procurement can be closed.

- 'Boycott' scenario: trading partners close completely their procurement markets (i.e. the closure of the so-called 'domestic opening' including products that manage to bypass those measures)

The 3 scenarios are possible. Yet, in our view, the scenario 'Simple Retaliation' is the most likely than 'Boycott scenario' or the 'No retaliation scenario'. Trading partners also benefit in an open trade environment and need specialised products from Europe. Finally, the Buy America policy in 2008 did not lead to anti-American boycotts, it led rather to Buy National measures affecting all foreign products of services, independently from their origin.

Impact on negotiating power and the level of openness of the international procurement markets:

Inconsistent policies by Member States could, furthermore, undermine the EU's credibility in trade negotiations. Third countries, aware of gaps between the specified level of access to EU procurement markets and the actual access conditions, may also remain reluctant to undertake market access commitments. This would especially be the case if trading partners have the possibility, without taking any legal commitments, of obtaining major contracts in Member States that maintain a significant degree of market opening, despite major restrictions taken in some other Member States.

Conversely, the imposition of disproportionate restrictions by certain Member States without coordination on the EU level may trigger disproportionate retaliation by trading partners against all EU companies, going beyond the current market access barriers met by them. The absence of a consistent EU framework may therefore jeopardize the EU efforts to convince third countries to open up their public procurement markets.

2.2 -Impact on competitiveness

Additionally, protectionist measures by trading partners like the Chinese indigenous innovation policy will lead to artificial technology transfers that may reduce the competitive edge of EU firms that manage to bypass the existing national restriction thanks to their highly-specialised products for which they are often the sole producers in the world (e.g. pharmaceuticals⁸). As a result, the current ability of high-tech sectors to not be targeted by existing measures may diminish over time.

⁸ Similarly, in the pharmaceutical industry, the development of generic drugs will naturally reduce the competitive edge of EU suppliers towards some of their competitors in third countries.

Multinationals from emerging economies (BRICs, Turkey) active in sectors depending on public procurement will certainly increase their worldwide market share in the coming years. They are likely to be attracted by the EU public procurement market, which is *de facto* open, further widening the existing disequilibria.

2.3 -Impact on compliance

The possible inconsistent or even conflicting measures taken by Member States or their procuring entities may put into question the EU's fulfilment of its procurement international commitments. National legislation on PRO can affect the compliance with the EU obligations in terms of national treatment or MFN under the GPA or FTAs.

In addition, they would undermine the unity of the common trade policy in contraction with the uniformity imposed by Article 207 of the TFEU.

Similarly, these diverging regulations and practices may interfere with the free circulation of goods and provision of services within the internal market, in breach of the treaty.

2.4 - Option 2B - reinforcement of trade negotiations

As indicated by the business trade associations during the Liaison Forum, to further open up public procurements across the globe, the EU could negotiate more forcefully.

Under this option, the EU would (1) systematically encourage trading partners to join GPA, TRADE comments : this is actually the baseline scenario since the strategy highlighted in the communication " global Europe" has been implemented(2) seek the development or the expansion of market access commitments on government procurement in existing FTAs (Chile, Mexico) or (3) try to convince trading partners to include market access in the discussions of the trade provisions of ongoing PCA negotiations (such as EU-Australia PCA)

In fact, except for Australia and Turkey, the EU is already negotiating forcefully along the aforementioned lines: it has recently concluded successfully the GPA negotiations with new markets (Canada, Korea, dismantling of Israeli offsets) or commitments to further negotiations (US, Japan) public procurement is an important part of the pre-conditions to launch the EU-Japan FTA, the EU has linked the conclusion of the EU-India FTA negotiations to a substantial procurement chapter, the EU-Mercosur negotiations were only re-launched on the condition of the inclusion of a public procurement chapter...as a result, India has submitted a new bill on procurement and Mercosur countries are negotiating the opening of procurement to each other.

The EU has still an ambitious set of negotiations programmed in the medium-term: Russia has taken commitments to join GPA, China's accession to GPA, bilateral negotiations with Japan and US, FTAs... , and possibly with a number of ASEAN countries beyond those with which negotiations are already on-going. .

Consequently, this option would basically amount to a continuation of existing policy and would fail to address one of the core issues, namely the lack of proper leverage to pry open third country PP markets.⁹

⁹ Pessimistic/Minimalistic and Optimistic/Maximalist outcomes of negotiations are described in the baseline scenario

3. Option 2A - legal clarification and enhanced use of existing mechanisms

Contracting entities could apply Article 58 on a more sound legal ground, and especially without encoring the risk of infringing international commitments short of understanding their scope (no 'strict' reciprocity as the scope of international commitments in utilities' procurement is known).

3.1 -Impact on public procurement market players and effectiveness

In the current situation, individual procuring entities have no incentive to use article 58 (2) for the following reasons:

- The mechanism is optional and therefore there is no requirement to comply with a legal obligation.
- The mechanism imposes the identification of foreign bids on the basis for PRO that makes up for an administrative burden.
- There is some legal uncertainty on the scope of international commitments and the determination of PRO.

The guidance provided by the Commission on international commitments and PRO would eliminate or at least significantly reduce the legal uncertainty (and actually improve the proper application of EU international commitments) and alleviate the administrative burden. However, the burden will remain as well as the absence of a mandatory character.

It can be expected that in some Member States, the improvement of legal certainty will be invoked by central government to advise a more frequent use of article 58 (2). However, utilities, which happen to be in partially liberalised sectors, may not be inclined to follow these recommendations. The case of instruction imposing the implementation of article 58(2) should be regarded as infringing the directive and, for some of them, their autonomy vis-à-vis central government in national legislations.

Based on all these assumptions, the use of Article 58 is therefore expected to increase, but not necessarily significantly. The effect of this device under Article 58 may de facto continue to be confined. For the purposes of the calculations of impacts, we shall estimate a neutral usage of 50% (tossing coin probability), as we predict that contracting authorities have no incentives to use it and therefore the percentage cannot be 100%.

3.2 - Impact on trade flows

Table III.1 - Scope of Article 58 and EU international commitments

	US	JP	CA	KR	IL	MX	TW	CN	RU	IN	BR	TR	UA	AU	
Defence	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	
Aerospace	0	1	0	0	1			-1	-1	-1	-1	-1	-1	-1	Art 58
Post & Apt sorting	-1	0	-1	-1	0	0		-1	-1	-1	-1	-1	-1	-1	Art 58
Firefight & Sea Rescue	1	1	0	1	1	0		-1	-1	-1	-1	-1	-1	-1	
Construction Dredging	0	1	0	1	1	0		-1	-1	-1	-1	-1	-1	-1	
Constr. Equipment	1	1	0	1	1	0		-1	-1	-1	-1	-1	-1	-1	
Railway equipment	-1	-1	-1	-1	0	-1		-1	-1	-1	-1	-1	-1	-1	Art 58
Urban buses	-1	-1	-1	-1	-1	1		-1	-1	-1	-1	-1	-1	-1	Art 58
Power generation	1	-1	-1	0	0	1		-1	-1	-1	-1	-1	-1	-1	Art 58
Water & Sewage	-1	1	-1	1	1	1		-1	-1	-1	-1	-1	-1	-1	Art 58
Waste mgmt & env	1	1	0	1	1	0		-1	-1	-1	-1	-1	-1	-1	
Pharmaceuticals	1	1	0	1	1	0	1	-1	-1	-1	-1	-1	-1	-1	
Medical equipment	1	1	0	1	1	0	1	-1	-1	-1	-1	-1	-1	-1	
Specialised textiles	1	1	0	1	1	0	1	-1	-1	-1	-1	-1	-1	-1	
Business services	0	0	0	0		-1		-1	-1	-1	-1	-1	-1	-1	
Financial services	-1	-1	0	0	-1	-1		-1	-1	-1	-1	-1	-1	-1	
Oil, Gas Min equipmt															
Fixed telecom eq.															
Computer & IT serv	0	0	0	1	1	0		-1	-1	-1	-1	-1	-1	-1	
Street lighting	1	1	1	1	1	0	1	-1	-1	-1	-1	-1	-1	-1	
Broadcasting equip	1	1	1	1	1	0	1	-1	-1	-1	-1	-1	-1	-1	
Port equipment	1	1	-1	1	1	1		-1	-1	-1	-1	-1	-1	-1	Art 58

As shown in Table 1, Option 2 would only affect 7 of the 22 markets selected (aerospace, sorting machinery for posts and airports, railway equipment, urban buses, power generation, water & sewerage and port equipment). It has no impact on construction, as this is a service. Port equipment is the market, which is the least affected, whereas the railway equipment sector is most covered.

Table III.2 - Impact of Article 58 (2) on market access

	Loss on PP market
United States	-11,3%
Japan	-10,1%
Canada	-16,4%
Korea	-11,9%
Mexico	-14,4%
Israel	-2,6%
China	-16,4%
Russia	-16,4%
India	-16,4%
Brazil	-16,4%
Turkey	-16,4%
Ukraine	-16,4%
Australia	-16,4%

Table III.3 - Impact of Article 58 on import of goods in the EU

IMPACT	Impact (Bn EUR)
Total Imports of goods in EU PP (including EEA/EFTA)	23,9
Impact of Article 58 on main GPA countries*	-0,75
Impact of Article 58 on main other countries*	-1,43
Total impact of Article 58*	-2,18
Imports of goods if Article 58 (2) applied systematically (including EEA/EFTA)	21,7

Source: SBS DG ENTR, EU GPA report and own calculations

*None of the EEA/EFTA countries has been considered as "impacted"

The procurement falling under Article 58 covered 2 billion EUR of goods imports in 2007 from the 12 main trading partners, out of which 1,5 billion EUR come from non-GPA economies¹⁰ (cf. table 3).

Impact for trade flows of the 3 % price preference when bids obtain an equal scoring

Even if conditions were met for a systematic use of this mechanism, its effect would remain quite limited. Indeed, the mandatory mechanism applies only when bids from a third country obtain exactly the same scoring as an EU or GPA/FTA covered bid from third countries. In addition, the price preference is too low to seriously restrain the access to the EU utilities markets (cf problem analysis)

3.3 - Impact on exports - Retaliation

a) No retaliation scenario - no effect

b) Simple retaliation scenario - If trade partners apply a proportional retaliation, then the total impact on exports will be 0,4 billion EUR (reactions from Turkey, India and Australia).

c) Boycott scenario - In spite of the fact that Article 58 exists already since 1990, we could extrapolate that the systematic use of Article 58 provisions could *in extremis* lead to 1 billion EUR of retaliations. In this context, we will assume that any clarification of Article 58 will lead to a retaliation of trading partners of the same market proportion (i.e. if EU closes its market to China by 20%, then China will cut the existing access by 20%. we could extrapolate that the systematic use of Article 58 provisions could in a worst case scenario lead to 1 billion EUR of retaliations.

3.4 - Impact on innovation –

¹⁰ The value of 2 billion EUR has re-corrected the influence of aircraft in imports from US. Aircraft are seldom purchased by EU contracting authorities, yet they weight a lot in EU-US trade (Boeing).

The immediate impact in innovation is likely to be very small, as Article 58 (2) does not apply to the access in research and development services nor on service concessions (cf. infra).

On this limited scope, it gives the possibility to limit the benefit of key purchases like renewable power equipment, smart grids, air traffic equipment or high-speed trains to EU firms or firms that have a "substantial link to the EU economy" (both energy and transport are part of the 7th research programme).

However, based on the assumption presented in the introduction, restrictive measures would limit in parallel the incentive for innovation. This could be the case of some utilities like railways, postal services and electricity where there is an average number of three bids per tendering procedure.

3.5 - Impact on trade position of the EU - leverage and retaliation

Leverage - A reinforcement of Article 58 will only affect 16 of 50 offensive interest markets of third countries. It reduces the domestic opening gap between the EU and the 13 selected trading partners (except in Israel) as follows:

Table III.4- Estimated impact of full use of Article 58 (2) on domestic markets free of trade barriers ("domestic opening" of EU and main trading partners)

	TRADING PARTNER		EU27
	Above-threshold market	DOMESTIC OPENING	DOMESTIC OPENING Vis-à-vis trading partner
European Union	370	-	
United States	559	32%	89%
Japan	96	28%	90%
Canada	59	10%	84%
Korea	25	83%	88%
Mexico	20	75%	86%
Israel	2,1	75%	97%
China	83	0%	84%
Russia	18	36%	84%
India	19	55%	84%
Brazil	42	18%	84%
Turkey	23,7	0%	84%
Ukraine		60%	84%
Australia	20	50%	84%
TOTAL	967	40%	84%

The incentive to negotiate measured through the leverage index (ratio of country X and EU exports going through procurement NOT committed internationally) improves dramatically for the EU vis-à-vis Korea, Brazil, Turkey and, to a lesser extent, vis-à-vis Japan, Canada. However, interestingly, Option 2 does not fundamentally increase the leverage of the EU vis-à-vis the USA.

Table III.4 Leverage index of Option 2

	Option 2
	Leverage index
USA	1%
Japan	27%
Canada	21%
Korea	56%
Mexico	0%
Israel	0%
China	11%
Russia	17%
India	10%
Brazil	35%
Turkey	25%
Australia	0%

3.7 - Impact on public finances

This option would entail no costs for public administrations, as utilities are not part of the ESA95.

Unless regulated by Member States, the use of Article 58 it is optional and at the discretion of the utility itself, which will the weight and benefits of using it.

If all utilities were to use Article 58 and as a result relinquish one offer (the average number of offers for utilities is 3), then the potential impact would fall in the range of 26 to 50 million EUR (expected 'savings loss' from moving from 3 to 2 bids), therefore reducing by 0,25 % the current estimated savings resulting from the application of the PP directives.

This cost would be transferred to final users via fees of utilities services. Yet the amount is negligible in relation to the total expenditure of utilities in the EU.

Impact on GDP

Based on the CG simulation model and taking into account that it would be limited to the utilities sector, this mechanism would have no significant impact on EU GDP.

3.8 - Impact on administrative burden

If all utilities would decide to apply Article 58 and thus request systematically a certificate of origin, whose cost has been estimated to be 5 EUR, then the maximum total administrative burden will amount to 115.000 EUR. This will increase the total administrative burden of public procurement by 0,05 % (cf opinion of the High Level Group on administrative burden) and would not affect

the total cost of public procurement procedures (cf PWC study **that estimates the cost of PP procedures to 5 billion EUR**).

Due to low incentives for applying article 58 (2) despite the improvement of legal certainty, the effective administrative burden would be less important.

3.9- Impact for the environment

Enhanced application of article 58 (2) could negatively impact the diffusion of EU standard for the utilities sector. For instance, targets for reducing CO2 and other polluted gas emissions imposed by the directive on clean vehicle would be limited to the EU car industry.

At the same time, the obligation for EU utilities to source mostly EU goods may positively affect CO2 emission from reduced import. However, this impact is likely to be marginal if not negligible.

3.10-Impact on international commitments and legal certainty

Table III.5 - Remaining areas with potential implementation problems ("PB")

	US	JP	CA	KR	IL	MX	TW	CN	RU	IN	BR	TR	UA	AU
Defence	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Aerospace	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Post & Apt sorting	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Firefight & Sea Rescue	PB	PB	PB	PB	PB	PB		OK	OK	OK	OK	OK	OK	OK
Construction/Dredging	OK	PB	PB	PB	PB	OK		OK	OK	OK	OK	OK	OK	OK
Constr. Equipment	PB	PB	OK	OK	PB	OK		OK	OK	OK	OK	OK	OK	OK
Railway equipment	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Urban buses	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Power generation	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Water & Sewage	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Waste mgmt & env	PB	PB	PB	PB	PB	OK		OK	OK	OK	OK	OK	OK	OK
Pharmaceuticals	OK	PB	PB	PB	PB	OK		OK	OK	OK	OK	OK	OK	OK
Medical equipment	OK	PB	PB	PB	PB	OK		OK	OK	OK	OK	OK	OK	OK
Specialised textiles	PB	PB	OK	PB	PB	OK		OK	OK	OK	OK	OK	OK	OK
Business services	OK	OK	OK	OK	PB	OK		OK	OK	OK	OK	OK	OK	OK
Financial services	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Oil, Gas Minequipmt														
Fixed telecom eq.														
Computer & IT serv	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK
Street lighting	PB	OK	PB	OK	PB	OK		OK	OK	OK	OK	OK	OK	OK
Broadcasting equip	PB	OK	OK	PB	OK	OK		OK	OK	OK	OK	OK	OK	OK
Port equipment	OK	OK	OK	OK	OK	OK		OK	OK	OK	OK	OK	OK	OK

With a detailed guidance on the scope of non covered procurement for utilities sectors in goods, procuring entities should better understand in which case they can impose restrictions based on article 58 (2).

This would certainly avoid at least two types of wrongful implementations of article 58 (2):

- (1) Use of restrictions on procurement sectors other than goods for utilities
- (2) Restrictions based on erroneous “ strict reciprocity clause”

Such improvement would not concern procurement sectors out of the scope of article 58(2) and therefore not improve legal certainty for these sectors

3.11 - Article 59:

Effectiveness and behaviour of players

The implementation of article 59 is based on decisions by the Council upon proposal by the Commission.

In the past, the Council has adopted restrictive measures against the US on the basis of a stand -alone regulation.

If the Commission were to impulse a more proactive policy by tabling a concrete proposal, there is no possibility to predict what would be the position of the Council. No assumption can be done on the likelihood of the use of the mechanism for the future.

The analysis of market player's behaviour under this option¹¹ indicates that contracting authorities have all incentives to apply the restrictions, since they would be willing to avoid litigation risks (legal actions by EU bidders or infringement procedures by the Commission

Impact on GDP

Based on the CG simulation model and taking into account that impacts would be limited to the utilities sector, this mechanism would have no significant impact on EU GDP.

Impact on the environment

Enhanced application of article 59 could negatively impact the diffusion of EU standards for the utilities sector (green services such as water and waste treatment, noise abatement)

3.12- WTO dispute settlement mechanism

Effectiveness and behaviour of market players

Building up cases for the WTO/FTAs dispute settlement mechanism implies a close cooperation between the Commission and the Industry, especially when collecting concrete evidences of abusive practices.

Entering such a collaborative work with the industry raises specific difficulties in the areas of government procurement.

¹¹ For more details, please refer to methodological note C

In many instances, trade barriers opposed by procuring entities in third countries are based on indirect discriminations such as distorted use of qualification requirements or award criteria. It is therefore uneasy for individual companies to bring forward real evidences of unfair treatments. Even worst, individual businesses fear, that, in case of investigation based on specific procurement contracts, they could be identified by the trading partners as being the source for a WTO case and would be subject to retaliatory measures in the next tendering procedures.

Impact on negotiating power and level of opening of trading partners

By definition, the use of WTO/FTAs dispute settlement mechanism is limited to procurement covered by GPA or FTAs. It may enhance the level of enforcement of existing commitments but cannot bring additional leverage for negotiation with non-GPA/FTA countries or with GPA/FTAs partners on not covered procurement, unless the threat of a panel might add some pressure on the course of negotiations.

3.13- Infringement procedures by the Commission

Effectiveness and behaviour of players

Infringement procedures by the Commission could be based either on wrong implementation of article 58.2 (abusive rejection of third countries' bidders) or of article 58.3 (failure to reject bids falling into the scope of these provisions). It could also imply to conduct infringement procedures when the Council has decided the imposition of restrictive measures under article 59 and where procuring entities do not comply with these measures.

These two first scenarios pose a clear monitoring issue. Under the current directive and its implementing measures, there is no concrete possibility to track down the rejection of foreign bids, short of mandatory publication.

The Commission's awareness on possible infringements would rely mostly on complaints by stakeholders, third countries' suppliers or individual citizens.

As regard the implementation of article 58 (2) and (3), two adverse processes might occur. In case procuring entities would apply systematically these provisions, there is no doubt that third countries' suppliers would tend to complain on a regular basis. In the other hand, more developed guidance on international commitments should improve the level of compliance and therefore, concrete infringement cases should be reduced.

Likelihood of a better monitoring of article 59 based decisions will not be tested here since there is no evidence that these provisions would be much more implemented in the near future. Similarly, there is no point in measuring up the impacts of such a monitoring process.

Impact on trade flows:

As the systematic use of article 58 (2) would be still uncertain (given the absence of incentive for individual procuring entities), there is no evidence that a

reinforced monitoring process by the Commission would have any quantifiable impact on trade flows.

In case the Commission would be in a position to substantiate cases for failure to implement article 58 (3), it can be assumed that individual procuring entities would tend to enforce on a systematic basis these provisions, based on their aversion to risk of litigations. However, as mentioned above, the scope of article 58 (3) is too narrow to expect that such a systematic use will trigger a quantifiable impact.

Impact on negotiating power or level of opening of trading partners

As far as article 58(2) is concerned, an increased monitoring by the Commission will not directly increase the negotiating power or the level of opening of trading partners. Since the monitoring process would focus on the compliance with international commitments, it would rather secure procurement markets for foreign bids rather than opening third countries' markets.

However, from a systemic point of view, such a monitoring process may increase the level of confidence of EU trading partners when negotiating with the EU and therefore accept more easily to undertake market access commitments.

Conversely, a better monitoring of the implementation of article 58 (3) may have a direct impact on the EU negotiating position, even very limited. Since infringement procedures against MS would trigger a more systematic enforcement of these provisions, trading partners could perceive it as a signal and could be poised to react upon such a signal. However, the limited scope of article 58 (3) may restrict the significance of such a signal.

Impact on administrative burden:

The guidance should increase the level of compliance as described above. In parallel, a complaint driven infringement monitoring should result in the opening of some cases. Although it is difficult to assess the volume of cases the Commission would have to launch, we could estimate the additional administrative cost to be roughly 2 million EUR (i.e. one additional FTI)

4. Common elements to all legislative options

Core elements

Under all approaches the legislative initiative would:

1. Reflect in EU law the international market access commitments taken by the EU in the area of public procurement;
2. Define the treatment of "foreign" goods and "foreign" service providers in procurement not covered by these international commitments throughout the EU;
3. Grant goods and services originating in least developed countries (as defined by the UN) the same treatment as EU goods and services;
4. Determine rules of origin applicable to identify non EU goods and non EU service providers.

The scope of the legislative initiative would mirror the scope of the public procurement Directives 2004/17/EC and 2004/18/EC (i.e. same thresholds, etc) with the possible inclusion of service concessions at a later stage. The choice of this scope is based on the consideration that procurement contracts within the scope of these Directives present the most important business opportunities for cross-border trade within and outside the EU. The initiative would also exclude defence procurement, which is subject specifically to EU Directive 2009/81/EC¹².

The initiative would provide a definition of public procurement covered and **not covered** by the EU's international commitments¹³.

For the purposes of determining whether a procurement falls within the category of covered or non covered procurement, the initiative would establish "*procurement rules of origin*" (PROs) to identify the origin of goods and services included in tenders:

- The PROs for goods will be those in the Community Customs Code
- The origin of services will be established on the basis of the origin of the service supplier. On the basis of GATS definitions, this would mean that if the supplier is established outside the EU or in the EU, but owned or effectively controlled by foreign companies, the service would be considered to be foreign.

¹² Under this directive, Member States have retained the power to decide whether or not their contracting authority/entity may allow economic operators from third countries to participate in contract award procedures.

¹³ The definition of not covered procurement would include "unscheduled procurement" (procurement not explicitly offered in GPA/FTAs - e.g. railways and concessions in GPA - or not committed vis-à-vis countries that have no public procurement agreement with the EU) and "excluded procurement" (procurement explicitly excluded in GPA through country-specific derogations and reciprocity clauses. Country specific derogations regulating access to remedies would not be implemented as they could infer with rights that are constitutionally guaranteed in some Member States.

5. Options 3A

Contracting authorities and businesses are assumed to know the scope of potential restrictions in advance, based on guidance by the Commission that would come with the legislative option.

Under this approach EU contracting entities would be required, in principle, to exclude third country goods, services and companies not covered by the international commitments of the EU. **The EU public procurement market is therefore a priori closed.**

Still, under option 3A contracting authorities would be able to use "waivers" to depart from this closure, which would not exist under option 3C (cf. infra).

Usage of waivers in option 3A

However, in four cases (cf. infra) the initiative would establish "**exceptions**" to the obligation to exclude, and would empower the Commission with the possibility to complement exemptions listed in the instrument with additional derogations through the issuance of "**waivers**".

Waivers could be issued:

To avoid obstacles to the procurement of goods and services unavailable in the EU (e.g. fuel);
In cases of "emergency" and/or of "overriding reasons of general interest";
For health-related procurement (e.g. pharmaceuticals, medical equipment);
In case of disproportionate sourcing costs (e.g. fuel or computers).

EU contracting entities would be required to notify (*ex post*) the European Commission of their decision to accept third countries' goods, services and companies that are not covered by the EU's international commitments and the derogation on which they are based. This *ex post* notification would be made, for instance, in the *contract award notice*¹.

5.1.- Impact on public procurement market players

The analysis of market player's behaviour under this option¹⁴ indicates that contracting authorities have all incentives to apply the restrictions:

- They would be willing to void litigation risks (legal actions by EU bidders or infringement procedures by the Commission)
- They would face no additional administrative burden since the notification of rejection is done via existing advertising obligations (contract notice and contract award notice)

¹⁴ For more details, please refer to methodological note C

- The Commission's guidance also clarifies the scope of the waivers based on "sourcing constraints", "cases of emergency", "overriding reasons of general interest" and/or "disproportionate costs".

Option 3A

Contracting authorities know the CPV codes of the restrictions that apply to them; they also know the criteria during which they can invoke the "exceptions" to the restrictions. However, until receiving bids, a contracting authority may not be fully able to judge whether there are "sourcing constraints" or "disproportionate costs", or whether the restriction will be lifted for pharmaceutical products and medical equipment. Central governments are assumed to inform contracting authorities about "overriding reasons of general interest".

Businesses know the CPV codes where they could be discriminated (for GPA/FTA countries) or know that they are systematically discriminated (rest of the world). The latter will not even bother looking at TED anymore (except eventually for pharmaceutical products and medical equipment).

At the time of the bidding, businesses might face asymmetries of information if they cannot judge whether the contracting authority considers that there are "sourcing constraints", "cases of emergency", "overriding reasons of general interest" and/or "disproportionate costs". Such an asymmetry and its impacts on the decision to bid are avoided if the contract notice indicates whether the contracting authority intends to waive the restrictions on the aforementioned grounds.

5.2 - Impact on trade flows of goods and services

Table V.1 - Scope of international commitments and markets closed in option 3A

	International commitments vis-à-vis 13 selected countries													
	UE	US	JP	CA	KR	IL	MX	CN	RU	IN	BR	TR	UA	AU
Defence	2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Aerospace	1,5	0	1	0	0	1		-1	-1	-1	-1	-1	-1	-1
Post & Apt sorting	2	-1	0	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1
Firefight & Sea Rescue	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Construction Dredging	1	0	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Constr. Equipment	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Railway equipment	2	-1	-1	-1	-1	0	-1	-1	-1	-1	-1	-1	-1	-1
Urban buses	2	-1	-1	-1	-1	-1	1	-1	-1	-1	-1	-1	-1	-1
Power generation	1,5	1	-1	-1	0	0	1	-1	-1	-1	-1	-1	-1	-1
Water & Sewage	2	-1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1
Waste mgmt & env	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Pharmaceuticals	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Medical equipment	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Specialised textiles	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Business services	0,5	0	0	0	0		-1	-1	-1	-1	-1	-1	-1	-1
Financial services	0,5	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1	-1	-1
Oil, Gas &Min equipmt	0													
Fixed telecom eq.	0													
Computer & IT serv	1	0	0	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Street lighting	2	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Broadcasting equip	1	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Port equipment	2	1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1

Option 3A would affect all sectors as shown in Table 7. Among GPA Parties, most of the markets affected are utilities-related (aerospace, sorting machinery for posts and airports, railway equipment, urban buses, power generation, water & sewerage and port equipment) as well as financial services. Overall, option 3A would fully close 70% of all markets presented in Table 7. Option 3A has an

impact on construction in particular vis-à-vis US (local governments) and non-GPA Parties.

Table V.2 - Market access reflects EU international commitments

	TRADING PARTNER		EU27
	Above-threshold market (billion EUR)	Internationally committed	EU commitments vis a vis TRADING PARTNERS(country specific derogations included)
European Union	370	95% (maximum coverage offered)	
United States	559	32%	46%
Japan	96	23%	70%
Canada	59	4%	10%
Korea	25	77%	83%
Mexico	20	75%	-
Israel	2,1	75%	-
China	83	0%	0%
Russia	18	0%	0%
India	19	0%	0%
Brazil	42	0%	0%
Turkey	23,7	0%	0%
Australia	20	0%	0%
TOTAL	967	25%	18%

Under Option 3A, the EU closes its non-covered public procurements and, as a result, market access to third countries is limited to international commitments. The impact on GPA countries is limited for the US and Japan, but is strong vis-à-vis Canada. Of course, countries without agreement in the area of public procurement lose access to the EU public procurement market.

If all restrictions had been applied under Annex 3A in 2007 (simulation) to public procurement covered under the directives, some **7,5 billion EUR of goods** would have been impacted (0,7 % of all EU imports of goods in 2007) and foreign companies could have lost between 1,5 and 2 billion EUR of service contracts¹⁵. If service restrictions are applied on firms bidding for public service contracts from outside the EU, then the amount is less than 0,2 billion EUR.

Table V.3 - Impact of restrictions on real imports of goods (2007)

IMPACT (billion EUR)	
Imports of goods in EU PP	23,9
<i>Impact on main GPA countries</i>	-1,0
<i>Impact on main other countries</i>	-6,4
Total impact	-7,4
Imports of goods after restr	16,5

¹⁵ We have assumed that all companies identified as foreign did not have any substantial link to the EU, in reality, the real impact is much lower.

Table V.4 - Service contracts awarded to non-EU firms established in the EU (2007)

	Total value
Not committed	2 346 589 625
Committed	3 194 808 489

* PP awarded to a company despite the absence of international commitments

** PP awarded to foreign company in the scope of international commitments

Source: EU Official Journal, TED database

Table V.5 - Impact of restrictions on real imports of services (2007)

IMPACT (billion EUR)	
Imports of services in EU PP	3,9
<i>Impact on main GPA countries</i>	-0,83
<i>Impact on main other countries</i>	-0,55
Total impact	-1,38
Imports of services after restr	2,52

In addition, if Option 3A is applied systematically it can lead to the following sourcing constraints, and probably disproportionate consequences, in specific markets where:

- **Products are to a very large extent imported** such as **computers, medical equipment and fuel**. Imported computers represent 70% of all computers sold in the EU and the EU public procurement market absorbs 8% of the whole demand of computers. Moreover, the EU is largely dependent on fuel from third countries (Russia and Middle East), for which there are no EU competitors.
- **The number of bids is generally low**. This is notably the case for pharmaceutical products, medical equipment, maintenance services, tires, energy (fuel, gas, electricity) services from network industries (air transport, electricity distribution, helicopters, postal services...) - all these products and services were found to have less than 3 bids.

The existence of the waivers should however reduce the impact of sourcing constraints, especially if procuring entities can rely on exemption in case *overriding reasons of general interest*" for the maintenance of order and safety, public health and public morals. This may relax the shortage risk on purchases of pharmaceuticals, medical equipment, and eventually fuel.

Table V.6 - Impact of restrictions on real imports of goods (2007) if fuel, pharmaceuticals and medical equipment are "waived" from Option 3A

IMPACT (billion EUR)	
Imports of goods in EU PP	23,9
<i>Impact on main GPA countries</i>	<i>-0,85</i>
<i>Impact on main other countries</i>	<i>-5,15</i>
Total impact	-6
Imports of goods after restr	17,9

Table V.7- Impact of restrictions on real imports of goods (2007) if computers are ALSO included in the goods that can be "waived" from Option 3A

IMPACT (billion EUR)	
Imports of goods in EU PP	23,9
<i>Impact on main GPA countries</i>	<i>-0,74</i>
<i>Impact on main other countries</i>	<i>-2,46</i>
Total impact	-3,2
Imports of goods after restr	20,7

In terms of imports, if computers are to be waived, the impact for non-GPA countries is halved (China), as only some 2,5 billion EUR fall in the scope of the instrument. If the waivers are limited to pharmaceuticals and medical equipment, then the impact on option 3A will be very limited (mostly because the imports from the US fall in the current scope of the GPA).

Service concessions - Service concessions are a major exemption from the Classic and Utilities Directives. Although apart from individual anecdotal evidence for particular cases there seem to be no easily available statistical sources for the value of this expenditure. An impact assessment has been carried out in view of a possible legislative framework on service concessions. It seems that, during the period 2000-2006, public private partnerships have amounted to 230 billion EUR out of which 60 % appear to be services concessions

Finally, it is also important to take stock of the following unintended effects:

- **Retailers and wholesalers:** The restrictions will require retailers and wholesalers to modify their portfolio of products. In some cases, this may also broaden the actual impact of the instrument as retailers and wholesalers may fully exclude foreign goods altogether to avoid the costs of managing one inventory for public customers and one inventory for private customers.
- **Transit Infrastructure:** Ports and airports may see a slight reduction of their business as Option 3A hits 0,7% of imports that will not transit anymore by EU infrastructure.

- **Supply chains and processing trade in China:** Based on literature and Chinese statistics¹⁶, the potential processing trade affected by Option 3A would amount to **3,8 billion EUR**, with two-thirds taking place in **computers** and the remaining in **medical equipment** (12%) and **telecom** (10%). As Chinese state-owned firms represent 20% of all Chinese exports¹⁷, option 3A could hit some 260 million of these firms' turnovers. We can safely consider that EU firms re-exports to the EU from China that could be affected by Option 3A amount to maximum **0,4 billion EUR**¹⁸. **If Option 3A is not applied for computers, pharmaceuticals and medical equipment, then the impact could be lowered to 0,1 billion EUR.**
- **Supply chains and processing trade in the USA:** Based on data from the Transatlantic Council¹⁹, as 30% of EU imports from US are related party trade, the potential processing trade for EU firms affected by Option 3A would amount to **0,5 billion EUR**.
- **Overall**, by extrapolation, supply chains could be affected up to 6 billion EUR.

"Unintended "trade reallocation"

Some of procurement contracts that would be closed to goods and services originating in specific countries short of international commitments (unscheduled procurement) or on the basis of country-specific derogations (excluded procurement) could be certainly awarded to bidders from other GPA/FTAs partners whose access to the EU procurement markets is secured on the basis of these agreements.

The disjunction between the "nationality" of bidders and the origin of goods as well these reallocation processes would trigger reorganisation in the supply chain for our trading partners and also for the EU companies.

As the IT sector is concerned, normally it should not be affected, because computers are likely to fall under the waiver system because of 'sourcing constraints'. However, if that were not the case, option 3A restrictions affecting Chinese computers will be affecting Korean and Taiwanese manufacturer's supply chains. The 2,4 billion EUR sales of computers to EU contracting authorities hit by Option 3A are mostly produced by Korean and Taiwanese companies (to a lesser extent Japanese companies). These

¹⁶ Vanassche (2009), Branstetter-Foley (2007), the China's Ministry of Commerce lists of 200 largest exporters from China

¹⁷ Zhi Wang, Shang-Jin Wei, *The Chinese export bundle* in *Emerging Giants: China and India in the world economy* (Eichengreen-Gupta-Kuma), p.171

¹⁸ Vanassche (2009) EU, US, Japanese companies only represent 11% of the exports of the 200 largest Chinese exporters. Thus if we assume that all the processing trade to the EU is conducted by EU firms, we assume EU firms to be responsible for this 11% in EU-China trade.

¹⁹ *The Transatlantic economy, Annual Survey of Jobs, Trade and Investment between the US and Europe*, Center for Transatlantic relations John Hopkins University, Paul H. Nitze School of Advanced International Studies

companies from GPA countries could relocate their supply chains elsewhere to bypass the restrictions (the EU public procurement market absorbs 8% of all the demand for computers in the EU). Japanese and US computer producers may relocate their activities to their home countries (or to Romania, Bulgaria). If medical equipment is excluded, the other remaining sector is telecom equipment. The main EU telecom equipment manufacturers have important industrial activities in China.

This also means that this policy option could hurt the competitiveness of our firms who would be forced to change their production structure to bypass a protection measure that was imposed by the EU itself

5.3 -Economic impacts

Under Option 3A, foreign companies selling goods and services to EU contracting authorities may have to either **relocate** their activities to the EU or countries with whom the EU has agreements (via these unintended relocation phenomenon) or **abandon** the B2G market. For instance, further to the Buy America, a EU lighting company had to relocate its production for the US government to the US.

First and foremost, as explained, computers will be far the most impacted good.

There may be relatively large impacts on some specific sectors, in particular those with higher dependency on public procurement (defence, railways, urban buses, fire-fighting). Relocation in the EU could lead to higher cost of production, but not necessarily.

Additionally, option 3A might encourage foreign direct investment by firms from BRIC countries, which are at the eve of their internationalisation. For instance, the thriving Brazilian bus industry - which has not yet placed its foot in the EU market - might set up need to set up manufacturing activities in the EU to sell in the EU market, with positive consequences for EU jobs. (Low-cost activities could be off shored to countries like Romania and Bulgaria).

The pattern of new activities in the EU would depend on the structure of supply chains. Companies relocating activities from countries like China and India will tend to bring back to the EU low-added value activities, whereas companies relocating from US or Japan may tend to bring back high-added value activities. However, in sensitive industries like defence or R&D-intensive, this may be more limited as companies may fear the diffusion of technological knowledge.

However, the processes described above for trade flows are likely to limit the extent of relocation of production sites and FDI within the EU. As investment decisions take into account a broad set of criteria including pre-existing competitiveness (based on prices, tax and legal framework, innovation capacities), it can be anticipated that EU GPA/FTAs partners would benefit from this flows- especially emerging countries with which the EU has concluded or will conclude preferential trade agreements with market access commitments.

In parallel, it should be also assumed that the entry of new firms in the EU market could displace some of the other firms in the market.

Dynamic of these FDI result partially from the phenomenon of 'tariff jumping'. Companies bypass trade barriers by creating industrial activities the countries protected by those trade barriers.

The closure of certain EU markets will lead some industries to relocate in the EU in order to supply EU contracting authorities, in particular in those sectors that are mostly dependent from public procurement.

However, as soon as trading partners will open their own procurement markets, the 'tariff jumping FDI' in the EU will lose its raison d'être and companies may leave their presence in the EU inasmuch as the EU will be able to re-attract activity in those sectors where it has comparative advantages.

5.4 - Impact on international commitments and legal certainty

Thanks to explanatory documents, contracting authorities will understand goods of which countries can be discriminated. In these conditions, the EU international commitments will be respected and the consistency of EU trade policy will be ensured.

Legal certainty will be reliant on the clarity of the applicable rules of origin. Since the latter are the same throughout the EU, the treatment of foreign goods by contracting authorities will not vary, ensuring therefore the consistency of the EU public procurement policy.

5.5 - Impact on trade position of the EU - leverage and retaliation

Retaliation

a) No retaliation - no effect

b) Simple retaliation - The effects of measures taken in Turkey, India and Australia could impact EU exports by 1,1 billion EUR.

c) Boycott

As explained, in the introduction, different types of retaliatory measures are to be considered, especially in the case of an overall closing of the EU GP markets not committed internationally.

If the immediate retaliatory measures are focused on the access to markets not committed internationally, the EU may be exposed potentially to **4,6 billion EUR** of retaliation if the EU takes option 3A.

Leverage

Under the assumption that trading partners do not take any measures, the incentive to negotiate measured through the leverage index (ratio of country X and EU exports going through procurement NOT committed internationally) improves dramatically for the EU vis-à-vis the US, Japan, Korea, Canada but also in particular vis-à-vis the BRICs. The leverage vis-à-vis the USA improves dramatically vis-à-vis Option 3 and even more so if the instrument covers defence (same for Israel).

Should trading partners retaliate, and then the leverage index diminishes vis-à-vis Japan and remains stable vis-à-vis Korea and Canada (compared to the baseline scenario). Option 3A may in some cases slightly increase leverage vis-à-vis the US and BRIC countries even if one considers the risk of retaliation.

In terms of international stance, the EU will however lose certain credibility when requesting the market opening of other trading partner. , it would weaken the EU voice within the G20 when calling for trade liberalisation and containment of protectionist tendencies..

Table V.8- Leverage index of Option 3A

	Option 3A Leverage index
USA	23%
Japan	53%
Canada	41%
Korea	111%
Mexico	0%
Israel	0%
China	38%
Russia	102%
India	83%
Brazil	181%
Turkey	37%
Australia	80%

5.6 -Impact on public finances

Table V.9- Financial impact of losing one bid for contracting authorities

	Imports	Bids (t=0) -Mean-	Bids (t=1) -Mean -	Saving (t=0)	Saving (t=1)	Impact (billion EUR)
Services	1,22	4	3	-9,0%	-7,2%	-0,023
Goods	7,4	5	4	-10,5%	-9,0%	-0,108
Construction	0,15	4	3	-9,0%	-7,2%	-0,003
					Total	-0,133

If contracting authorities, which purchased non-EU goods, lost one bid out because of the restrictions of Option 3A, their saving loss would have been **133 million EUR**. If they lost 2 bids, the total saving loss would be 300 million EUR.

5.7- Impact on administrative burden

Notification process - Option 3A foresees that the contracting authority indicates in the contract notice, if it intends to waive the public procurement on the grounds of "disproportionate costs", "sourcing constraints" and "overriding reasons of general interest" and to inform it ex-post in the contract award notice.

As the standard forms are mandatory for the publication of a call for tender and is a current obligation, there is no additional administrative burden.

If contracting authorities have to send a full notification to the European Commission to issue waivers for instance for computers, fuel, medical equipment and pharmaceuticals, then the total administrative burden will amount to **1.989.000 EUR**.

Certificates of origin - Under option 3A, businesses will have to systematically provide certificates to prove the origin their goods and or a document to prove that they are either an EU company or a company originating in a GPA/FTA partner for covered procurement. As the cost of the certificate of origin has been estimated to be 5 EUR, then the total administrative burden will amount to **3.450.000 EUR²⁰**.

This maximal cost of **5.439.000 EUR** may be lowered if:

- There is for the time being no certificate designed specifically to identify the origin of a company. However, it is assumed here that service providers use existing documents to justify the location of their registered office as well as their capital via information relating to their financial capacity (e.g. financial accounts). This might not be always sufficient to prove a substantial link to the EU economy.
- Certificates are asked only for the winning bid.

²⁰ The procurement procedures of computers, fuel, medical equipment and pharmaceuticals represent 15% of all procedures.

6. Option 3B

6.1 -Impact on public procurement market players

1) Rejection by individual procuring entities under the supervision of the Commission (3B1)

This approach has much communality with the existing mechanism of article 58 (2) except for two major elements:

- A much broader scope (both directives and potentially service concessions).
- A prior notification system imposing that the rejection of foreign bids can be effectively implemented only after the Commission has issued a decision.

These 2 parameters might influence in different ways the behaviour of market players in comparison with article 58(2).

A broader scope implies that all types of procuring entities, including central government entities, can consider rejection measures. These entities might be much more prone to use this mechanism despite the disincentive effects listed under the analysis of article 58 (2), since they are more likely to fulfil national trade policy objectives. As regard local procuring entities, some of them might be tempted to use the mechanism to favour some local competitors.

The notification process can play both ways on the behaviour of procuring entities. An additional procedural requirement produces an obvious disincentive effect in terms of administrative burden. The period for the review by the Commission is a cost of opportunity on the contracting authority. The procedure period increases substantially (figures for 30 days): 58% for open procedures (in classical sector and utilities), 38% for restricted procedures (in classical sector) and 100% for contracting authorities choosing to shorten their deadlines through PINs and electronic procedures.

However, the perception of this additional burden will partially depend on the functioning of the notification process (see below sub-options on notification).

Conversely, the supervision by the Commission might be regarded as a legal guarantee. It cannot be excluded that some procuring entities would more feel comfortable in considering a rejection if they anticipated a legal check by the Commission when dealing with the notification.

As a result of all these parameters, Approach 3 B1 would certainly be mainly used on markets where a Member State has an offensive interest and/or a local authority may wish to protect a local economic activity.

Notification procedure

Contracting authorities announce in the contract notice that they are likely to reject foreign bids for not covered procurement. If they receive foreign bids within the time period for the submission of tenders, they notify their intention to reject them to the Commission.

For "foreign" service providers and for businesses with foreign goods, this mechanism triggers uncertainty. It can be assumed that the mere fact that the contracting authority will put forward its intention to reject foreign bids in the contract notice is a deterrent to participate. However, there is a risk that the Commission objects the rejection and some of them might take the risk to submit a bid.

For the procuring entity, the review would interfere with the conduct of the tendering procedure and can increase the legal uncertainty as well.

The period of decision by the Commission would last 6-8 weeks.

Also, it cannot be excluded that objections by the Commission would create risks of litigation. MS courts or even the ECJ, based on principles of procurement law, might deem, if the Commission recognizes that bids originated in a specific country should be admitted, that this recognition should benefit to all suppliers selling products or services from this country. As an outcome, they should be given a chance to participate in the tendering procedure on an equal footing. This might imply at least to make public the Commission's decisions and to extend the time period for submitting bids.

2) Commission can take measures against closed procurement markets (3B2)

The Commission driven instrument would work on the basis of complaints of EU businesses in third countries of public procurement procedures and *ex officio*, on the initiative of the Commission.

Opening of a case

Individual companies' decisions to complain with a view to triggering a MASP procedure would depend on their respective market access situation in third countries and their legitimate expectations towards the outcome of restrictive measures.

It can be assumed that important companies that manage to be awarded contracts on the basis of competitive advantages or that have obtained a certain market share through joint ventures might be reluctant to complain, anticipating risks of retaliation.

By contrast, in procurement markets that are totally closed for EU bidders (construction market in China), individual companies might take the risk of lodging a complaint.

It is therefore difficult to predict the level of complaints. It is therefore necessary to make a minimalistic scenario (no complaints) and a maximalist scenario (complaints for all EU's offensive interests).

Imposition of restrictive measures under the Commission driven instrument

Since the restrictive measures imposed under the Commission driven instrument would be mandatory for procuring entities with the exemption provided by waivers, EU procuring entities would certainly react as they would do under the approach 3 A.

They have all incentives to apply the restrictions:

- They would be willing to avoid litigation risks (legal actions by EU bidders or infringement procedures by the Commission).
- They would face no additional administrative burden since the rejection is indicated via existing advertising obligations (contract notice).
- The Commission's guidance also clarifies the scope of the waivers based on "sourcing constraints", "cases of emergency", "overriding reasons of general interest" and/or "disproportionate costs".

Same behaviour might also be expected from foreign suppliers. The publication of the scope of rejection in the contract notice would prevent them from submitting bids. The only asymmetry of information likely to occur would consist in a lack of clarity on the exemption the entity intends to apply. This would be avoided if the instrument imposes entities to indicate in the contract notice the exemption applicable.

3) Cumulating 3 B1 and 3B2

3B1 and 3B2 are complementary as they combine the needs of contracting entities and businesses. Contracting entities are the drivers of the mechanism foreseen under option 3B1, whereas businesses are the drivers of the mechanism foreseen in option 3B2.

6.2 -Impact on trade flows

1) 3 B 1

During the very first years of implementation, third countries cannot predict the behaviour of contracting authorities in the EU as well as the policy of the Commission in terms of objections. They will over time gain information on the real level of rejection by procuring entities, and on the orientations of the Commission, based on objection decisions.

As a result, if third countries might first consider that access to the EU public procurement market is only guaranteed to those areas that have been committed internationally (the assessment as under 3 A), their perception might rapidly equal the perception they might have for the implementation of article 58(2) under option 2 given the expected impact on procuring entities. Somehow, the

"case law" resulting from the Commission' decisions might produce more predictability than under article 58 (2) .

Table VI.1 - Scope of int'l commitments and markets "closable" in option 3B

	International commitments vis-à-vis 13 selected countries													
	UE	US	JP	CA	KR	IL	MX	CN	RU	IN	BR	TR	UA	AU
Defence	2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Aerospace	1,5	0	1	0	0	1		-1	-1	-1	-1	-1	-1	-1
Post & Apt sorting	2	-1	0	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1
Firefight & Sea Rescue	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Construction Dredging	1	0	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Constr. Equipment	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Railway equipment	2	-1	-1	-1	-1	0	-1	-1	-1	-1	-1	-1	-1	-1
Urban buses	2	-1	-1	-1	-1	-1	1	-1	-1	-1	-1	-1	-1	-1
Power generation	1,5	1	-1	-1	0	0	1	-1	-1	-1	-1	-1	-1	-1
Water & Sewage	2	-1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1
Waste mgmt & env	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Pharmaceuticals	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Medical equipment	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Specialised textiles	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Business services	0,5	0	0	0	0		-1	-1	-1	-1	-1	-1	-1	-1
Financial services	0,5	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1	-1	-1
Oil, Gas &Min equipmt	0													
Fixed telecom eq.	0													
Computer & IT serv	1	0	0	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Street lighting	2	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Broadcasting equip	1	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Port equipment	2	1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1

As shown in Table VI.1 Option 3B 1 could affect all sectors. Among GPA Parties, most of the markets affected are utilities-related (aerospace, sorting machinery for posts and airports, railway equipment, urban buses, power generation, water & sewerage and port equipment) as well as financial services.

Under Option 3B 1 EU procuring entities can "close" their non-covered public procurements and, as a result, constant and fully predictable market access to third countries is limited to international commitments. The impact on GPA countries is limited for the US and Japan, but is strong vis-à-vis Canada. Of course, countries without agreement in the area of public procurement lose access to the EU public procurement market.

Of course, if EU contracting authorities would decide to systematically apply international commitments, the effect of Option 3B1 would be the same as for Option 3A. Therefore, the *maximum maximum* impact in terms of goods would be **7,5 billion EUR of goods** would have been impacted (0,7 % of all EU imports of goods in 2007) and foreign companies could have lost between 1,5 and 2 billion EUR of service contracts²¹.

It can be assumed that contracting authorities will never apply the restrictions when buying computers, medical equipment, pharmaceuticals and fuel. To compare option 3B with other options, a relative rate of usage of restrictions of 25% shall be considered (since 50% is a neutral rate of use).

Table VI.2 - Impact of restrictions on real imports of goods (2007)

IMPACT (billion EUR)	2007
Imports of goods in EU PP	23,9
<i>Impact on main GPA countries</i>	-0,74
<i>Impact on main other countries</i>	-0,59
Total impact	-1,33
Imports of goods after restr	22,6

Table VI.3 - Impact of restrictions on real imports of services (2007)

IMPACT (billion EUR)	2007
Imports of services in EU PP	3,9
<i>Impact on main GPA countries</i>	0,83
<i>Impact on main other countries</i>	0,26
Total impact	1,09
Imports of services after restr	2,81

Under a rate of usage of 25%, option 3B will lead to a *maximum estimated* restrictions worth 1,1 billion EUR

The impact on trade flows will depend on the assessment by the Commission of the market access situation on third countries. Such assessment will rely on the existence of market access reservation as laid down under the GPA/FTAs but also on the effective market access granted or denied to the EU suppliers, goods and services.

²¹ We have assumed that all companies identified as foreign did not have any substantial link to the EU; in reality, the real impact is much lower.

2) Commission driven instrument (3 B2)

The impact of 3B2 on trade flows would be the result of the mandatory closing of certain segments of procurement markets for bids originating in specific third countries.

As for the **maximum reach** of the Commission instrument, estimate done for the analysis of 3 A and 3 B1 are largely applicable. In theory, the Instrument could be deployed on the entire scope of not committed procurement. (**7,5 billion EUR of goods** and 1,5 and 2 billion EUR of service contracts²² or foreign bidders have been concerned).

The difference is that, based on the range of restrictive measures available under 3 B2 (rejection or price preference), the amount of contracts potentially lost for foreign companies should be less important. Indeed, a price preference would have a less discriminatory impact than a rejection until a certain rate.

As regards the **effective impact** on trade flows, several parameters have to be taken into account.

3 B2 implies first the existence of market access problem in third countries. Where market access problem are not reported, restrictive measures will not be considered.

In addition, this mechanism includes an initial phase where the Commission would first seek negotiation before imposing restrictive measures. As a result, certain trading partners' companies will be sheltered from the restrictive measures during the time negotiations are conducted.

Even more importantly, restrictive measures will be adopted on a selective approach. Before taking any restriction, the Commission will try to target sectors where our trading partners have an offensive interest in the EU and where the negative impact for the EU should be limited (public finances, etc).

3) Cumulating 3 B1 and 3 B2:

Approach 3 B implies to have both mechanisms coexisting and therefore to combine the impacts, especially the impact on trade flows.

The maximum impact has been analysed above, since for each mechanism it has been assumed that, for the need of the impact assessment, restrictive measures could be in theory applied to all not committed procurement. These figures (**7,5 billion EUR of goods** and 1,5 and 2 billion EUR of service contracts²³ or foreign bidders have been concerned) stand for the maximum cumulative effect of 3B as a whole.

As regards the effective impact on trade flows, the features of each mechanism impose a great deal of communality.

²² We have assumed that all companies identified as foreign did not have any substantial link to the EU, in reality, the real impact is much lower.

²³ We have assumed that all companies identified as foreign did not have any substantial link to the EU, in reality, the real impact is much lower.

Especially for unscheduled procurement, the Commission should object when there is no "substantial reciprocity", implying a satisfactory level of de facto market access. Similarly, 3 B2 restrictive measures will not be used against foreign bids from a specific third country where no market access problem has been reported.

Finally, overlaps should be also expected for sectors impacted by the exemption under 3 B 2 (identical for 3 A). Based on their own assessment of their sourcing constraints, individual procuring entities will on their initiative refrain from rejecting bids in these areas (see above impact on trade flows for 3 B1).

As impacted trade flows are concerned, overlaps are unlikely.

Under 3 B, individual procuring entities would not be allowed to take restrictive measures impacting a specific sector in a third country when the Commission has already adopted measures.

As the motivation of the Commission and procuring entities may vary, there is also the possibility that certain central government authorities or local entities would impose restrictions that the Commission would not adopt.

6.3 - Economic impacts

Impact on international commitments and legal certainty

1) 3 B 1

Thanks to explanatory documents, contracting authorities will understand goods of which countries can be discriminated. In these conditions, the EU international commitments will be respected and the consistency of EU trade policy will be ensured.

As the Commission will be consulted for each derogation request, there is a additional guarantee of legal certainty and clarity over the application of the existing restrictions compared to article 58 (2) .

2) 3 B2

3B2 should provide the same level of legal certainty and compliance as 3 A. With the support of the Commission guidance, procuring entities have incentive to implement restrictive measures and to make use of the exemption laid down in the instrument

6.4 - Impact on trade position of the EU - leverage and retaliation

Retaliation

a) No retaliation - no effect

b) Simple retaliation - if India and Australia introduce protectionist measures and Turkey reinforces them at the same level as the EU (25% of the market affected), then impact of retaliation could add up to 0,5 billion EUR.

c) Boycott - if all trading partners apply a proportional closure to their domestic markets then the total impact of retaliation could add up to 1 billion EUR.

Impact on negotiations and leverage

Impetus for negotiations

Due to the absence of a initial massive closing of the EU procurement markets, the EU credibility as a negotiating partner should be preserved.

1) 3 B 1

The unpredictability of restrictive measures may fuel a need for legal protection and the, to secure market access via reciprocal commitments.

The fact that the Commission is conducting a prior review based on effective market access situation conveys the message that rejections are not driven by protectionist concerns and may therefore comfort willingness to negotiate.

2) 3B 2

As the procedure is based on a prior attempt for negotiation before imposing measures, the instrument clearly gives an incentive for starting market access discussions. Conversely, the credibility of the instrument may impose that the Commission starts with some first strong case and imposes restrictions in order to make the threat effective

Leverage

3B maximises the leverage of the EU, for two reasons:

- Public procurement markets not covered by the EU's international commitments can be closed at any moment by contracting authorities under option 3B1
- The EU can fine-tune restrictions in option 3B2 by selecting on purpose public procurement markets, where third countries have offensive interests.

As trading partners know that the EU is in a capacity to close the whole public procurement not committed internationally, the real leverage under Option 3B is the one of international commitments (including for the trading partners, as it can also close its domestic procurement to retaliate).

6.5 - Impact on public finances

If contracting authorities, which purchased non-EU goods, lost one bid out because of the restrictions of Option 3A, their saving loss would have been **42 million EUR**. If they lost 2 bids, the total saving loss would be 100 million EUR.

Table VI.3 - Financial impact of losing one bid for contracting authorities

	Imports	Bids (t=0)	Bids (t=1)	Saving (t=0)	Saving (t=1)	Impact (billion EUR)
Services	1,09	4	3	-9,0%	-7,2%	-0,020
Goods	1,33	5	4	-10,5%	-9,0%	-0,019
Construction	0,14	4	3	-9,0%	-7,2%	-0,003
					Total	-0,042

6.6 - Impact on administrative burden

1) 3 B 1

Notification process - Option 3B foresees that the contracting authority indicates in the contract notice, if it intends to use the possibility to discriminate.

Contracting authorities use the contract award notice to notify the Commission, then there is no additional administrative burden as the standard forms are mandatory for the publication of a call for tender.

If contracting authorities have to send a full notification to the European Commission, then they will do it when a foreign good has been received. While it could be considered this process is time saving for the contracting entities, however there is no predictability on the date for the submission of foreign bids. If they are submitted at the end of the time period for presenting bids, which is often the case, then the review will trigger an extension of the tendering procedure by 6-8 weeks.

In this context the notification system will cost 97.859 EUR for contracting authorities for the notification itself (554 notifications - cf. infra- dealt for 4 hours - this period is derived the questionnaires to contracting authorities).

Contracting authorities will have to wait for 6 to 8 weeks for a decision from the Commission. If the value of all the concerned contracts had been put in a bank for that period at an interest rate of 3%, it would have generated 38 million EUR.

Certificates of origin - Under option 3B, businesses will have to provide certificates to prove the origin their goods and or a document to prove that they have a substantial link with the EU economy.

As the cost of the certificate of origin has been estimated to be 5 EUR, then the total administrative burden will amount to **3.450.000 EUR**²⁴.

This maximal cost of **3.547.000 EUR** may be lowered if:

- Service providers use their certificate of financial capacity (e.g. financial accounts) to prove that they are established in the EU - although this does not solve the problem of definition of the "substantial link with the EU economy".

²⁴ The procurement procedures of computers, fuel, medical equipment and pharmaceuticals represent 15% of all procedures.

- Certificates are asked only for the winning bid.

Commission resources

Option 3B1- If we consider the volume of contracts (1,1 billion EUR) by the average values of contracts in the EU, we obtain a total of 554 notifications per year in option 3B1. If 3 officials are hired to handle the 554 notifications, each of them will have to deal with 180 notifications a year or almost one per day - we estimate that the verification of 'substantial reciprocity' will last at the very maximum one day. There are economies of scale associated with these tasks, in particular when they focus systematically on the same sectors and the same countries. Annex 8 provides already a preliminary assessment of the substantial reciprocity tests. The 3 officials will come at a cost of 187.000 EUR (with 25% overhead).

Option 3B2 - This option should be handled by an additional official (as EU procurement exports amount only to 1% of all EU exports, if the anti-dumping service of DG TRADE has 154 officials, proportionally the Commission only needs an additional official).

7. Option 3C

Contracting authorities and businesses are assumed to know the scope of potential restrictions in advance, based on guidance by the Commission that would come with the legislative option.

Options 3A and 3C

Under the first approach EU contracting entities would be required, in principle, to exclude third country goods, services and companies not covered by the international commitments of the EU. **The EU public procurement market is therefore a priori closed.**

7.1.- Impact on public procurement market players

The analysis of market player's behaviour under this option²⁵ indicates that contracting authorities have all incentives to apply the restrictions:

- They would be willing to void litigation risks (legal actions by EU bidders or infringement procedures by the Commission)
- They would face no additional administrative burden since the notification of rejection is done via existing advertising obligations (award notice)

Option 3C

Contracting authorities know the CPV codes of the restrictions that apply to them; they also know the criteria during which they can invoke the "exceptions" to the restrictions. However, until receiving bids, a contracting authority may not be fully able to judge whether there are "sourcing constraints" or "disproportionate costs", or whether the restriction will be lifted for pharmaceutical products and medical equipment. Central governments are assumed to inform contracting authorities about "overriding reasons of general interest".

Businesses know the CPV codes where they could be discriminated (for GPA/FTA countries) or know that they are systematically discriminated (rest of the world). The latter will not even bother looking at TED anymore (except eventually for pharmaceutical products and medical equipment).

At the time of the bidding, businesses might face asymmetries of information if they cannot judge whether the contracting authority considers that there are "sourcing constraints", "cases of emergency", "overriding reasons of general interest" and/or "disproportionate costs". Such an asymmetry and its impacts on the decision to bid are avoided if the contract notice indicates whether the contracting authority intends to waive the restrictions on the aforementioned grounds.

²⁵ For more details, please refer to methodological note C

7.2 - Impact on trade flows of goods and services

Table VII.1 - Scope of international commitments and markets closed in option 3A

	International commitments vis-à-vis 13 selected countries													
	UE	US	JP	CA	KR	IL	MX	CN	RU	IN	BR	TR	UA	AU
Defence	2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Aerospace	1,5	0	1	0	0	1		-1	-1	-1	-1	-1	-1	-1
Post & Apt sorting	2	-1	0	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1
Firefight & Sea Rescue	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Construction Dredging	1	0	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Constr. Equipment	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Railway equipment	2	-1	-1	-1	-1	0	-1	-1	-1	-1	-1	-1	-1	-1
Urban buses	2	-1	-1	-1	-1	-1	1	-1	-1	-1	-1	-1	-1	-1
Power generation	1,5	1	-1	-1	0	0	1	-1	-1	-1	-1	-1	-1	-1
Water & Sewage	2	-1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1
Waste mgmt & env	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Pharmaceuticals	1	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Medical equipment	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Specialised textiles	2	1	1	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Business services	0,5	0	0	0	0		-1	-1	-1	-1	-1	-1	-1	-1
Financial services	0,5	-1	-1	0	0	-1	-1	-1	-1	-1	-1	-1	-1	-1
Oil, Gas &Min equipmt	0													
Fixed telecom eq.	0													
Computer & IT serv	1	0	0	0	1	1	0	-1	-1	-1	-1	-1	-1	-1
Street lighting	2	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Broadcasting equip	1	1	1	1	1	1	0	-1	-1	-1	-1	-1	-1	-1
Port equipment	2	1	1	-1	1	1	1	-1	-1	-1	-1	-1	-1	-1

Option 3C would affect all sectors as shown in Table 7,. Among GPA Parties, most of the markets affected are utilities-related (aerospace, sorting machinery for posts and airports, railway equipment, urban buses, power generation, water & sewerage and port equipment) as well as financial services. Overall, option 3C would fully close 70% of all markets presented in Table 7. Option 3C has an

impact on construction in particular vis-à-vis US (local governments) and non-GPA Parties.

Table VII.2 - Market access reflects EU international commitments

	TRADING PARTNER		EU27
	Above-threshold market (billion EUR)	Internationally committed	EU commitments vis a vis TRADING PARTNERS(country specific derogations included)
European Union	370	95% (maximum coverage offered)	
United States	559	32%	46%
Japan	96	23%	70%
Canada	59	4%	10%
Korea	25	77%	83%
Mexico	20	75%	-
Israel	2,1	75%	-
China	83	0%	0%
Russia	18	0%	0%
India	19	0%	0%
Brazil	42	0%	0%
Turkey	23,7	0%	0%
Australia	20	0%	0%
TOTAL	967	25%	18%

Under Option 3C, the EU closes its non-covered public procurements and, as a result, market access to third countries is limited to international commitments. The impact on GPA countries is limited for the US and Japan, but is strong vis-à-vis Canada. Of course, countries without agreement in the area of public procurement lose access to the EU public procurement market.

Still, under option 3C, contracting authorities will still request the Commission to accept foreign offers, when these are unavoidable or because these have a substantial edge in terms of quality or price. There are good reasons to assume that these unavoidable offers will be found in the same sectors as those already identified in option 3A (pharmaceuticals, medical equipment, fuel and computers). Since the EU pharmaceutical sector does not appear to face any problems of access (except in India) (cf. industrial analysis), nor most of medical equipment - except for very basic medical supplies -, because of its revealed quality elasticity and high-skills, "substantial reciprocity tests" will not lead the Commission to block access. For computers or fuel, the situation is likely to be different. But, on the other hand, the Commission may need to be pragmatic given the relative dependence of the EU on these imports.

Finally, under option 3C, Commission decisions to accept foreign products and services will be based on "substantial reciprocity tests", that is mostly on the analysis of domestic opening. In these circumstances, since 10% of the procurement market of the 12 main trading partners is opened domestically,

rejections will be as systematic as in option 3A. We shall assume that the option 3C will lead to a 75% usage (by symmetry with the 50% neutral usage of option 2, the 100% usage of option 3A and the 25% usage of option 3B).

All in all, taking into consideration the systematic usage of requests to accept foreign goods for fuel, pharmaceuticals, medical equipment and computers and the 25% of usage for other goods and services (i.e. 75% of usage if restrictions), then the impact of option 3C on import of goods is some 3 billion EUR (which corresponds to some 75% of the 4 billion EUR of option 3C).

7.3-Economic impacts

Impact on international commitments and legal certainty

Thanks to explanatory documents, contracting authorities will understand goods of which countries can be discriminated. In these conditions, the EU international commitments will be respected and the consistency of EU trade policy will be ensured.

Legal certainty will be reliant on the clarity of the applicable rules of origin. Since the latter are the same throughout the EU, the treatment of foreign goods by contracting authorities will not vary, ensuring therefore the consistency of the EU public procurement policy.

Impact on trade position of the EU - leverage and retaliation

Retaliation

a) No retaliation - no effect

b) Simple retaliation - the proportional retaliation by India, Turkey and Australia could lead to some 1,1 billion EUR of retaliation (half of which would come from Turkey)

c) Boycott

As explained, in the introduction, different types of retaliatory measures are to be considered, especially in the case of an overall closing of the EU GP markets not committed internationally.

If the immediate retaliatory measures are focused on the access to markets not committed internationally, the EU may be exposed potentially to **4,6 billion EUR** of retaliation if the EU takes option 3C.

Leverage

Table VII.3- Leverage index of Option 3C

	Option 3C Leverage index
USA	17%
Japan	40%
Canada	31%
Korea	83%
Mexico	0%
Israel	0%
China	28%
Russia	77%
India	50%
Brazil	136%
Turkey	31%
Australia	56%

Impact on public finances

Table VII.4 - Financial impact of losing one bid for contracting authorities

	Imports	Bids (t=0) -Mean-	Bids (t=1) -Mean -	Saving (t=0)	Saving (t=1)	Impact (billion EUR)
Services	1,22	4	3	-9,0%	-7,2%	-0,023
Goods	7,4	5	4	-10,5%	-9,0%	-0,108
Construction	0,15	4	3	-9,0%	-7,2%	-0,003
					Total	-0,133

If contracting authorities, which purchased non-EU goods, lost one bid out because of the restrictions of Option 3C, their saving loss would have been **133 million EUR**. If they lost 2 bids, the total saving loss would be 300 million EUR.

7.4 - Impact on administrative burden

Notification process - Under option 3C contracting authorities have to send a full notification to the European Commission to issue requests to accept:

- Foreign computers, fuel, medical equipment and pharmaceuticals (this will result in 1952 notifications)

- An estimated 25% of remaining goods and services (this will result in 1476 notifications)

In this context the notification system will cost 606.171 EUR for contracting authorities for the notification itself (3429 notifications - cf. infra- dealt for 4 hours - this period is derived the questionnaires to contracting authorities).

Contracting authorities will have to wait for 6 to 8 weeks for a decision from the Commission. If the value of all the concerned contracts (some 7 billion EUR) had been put in a bank for that period at an interest rate of 3%, it would have generated 216 million EUR.

Certificates of origin - Under option 3C, businesses will have to systematically provide certificates to prove the origin their goods and or a document to prove that they are either an EU company or a company originating in a GPA/FTA partner for covered procurement. As the cost of the certificate of origin has been estimated to be 5 EUR, then the total administrative burden will amount to **3.450.000 EUR**²⁶.

This maximal cost may be lowered if:

- There is for the time being no certificate designed specifically to identify the origin of a company. However, it is assumed here that service providers use existing documents to justify the location of their registered office as well as their capital via information relating to their financial capacity (e.g. financial accounts). This might not be always sufficient to prove a substantial link to the EU economy.
- Certificates are asked only for the winning bid.

Commission resources

- Option 3C- If we consider the volume of contracts (7,1 billion EUR) by the average values of contracts in the EU, we obtain a total of 3429 notifications per year in option 3B1. If each official has to deal with 180 notifications a year or almost one per day - we estimate that the verification of 'substantial reciprocity' will last at the very maximum one day - then up to 20 officials will have to be hired. There are economies of scale associated with these tasks, in particular when they focus systematically on the same sectors and the same countries. Annex 8 provides already a preliminary assessment of the substantial reciprocity tests. The 20 officials will come at a cost of 2,5 million EUR (with 25% overhead).

The total administrative burden of option 3C will be some 222 million EUR, hence as much as the current whole burden of public procurement.

²⁶ The procurement procedures of computers, fuel, medical equipment and pharmaceuticals represent 15% of all procedures.

8. Option 4: Legislative Approach without supervision by European Commission ('Article 58')

The effects of option 4 will be similar to those of a weaker option 3A, except for the administrative burden. Article 58 will never be used for medical equipment, fuel, pharmaceuticals and computers. For other goods, as in option 2, we can assume a rate of use of 50%.

8.1-Rules clarification: Under option 4, the guidance on the EU international commitments as well as on PRO would improve legal certainty and avoid the problems caused by the erroneous use of symmetric reciprocity clauses. **Yet, final decisions on access would be taken by contracting authorities themselves.** This would improve the consistency of internal market and trade policy, but would not fully ensure it.

8.2. Competitiveness (equal level playing field): (cf. option 3A)

8.3. Impacts on incoming trade flows:

-Imports: The potential impact on trade flows would be important as option 3A could affect up to 9.1 billion EUR of imports of goods and services. However, as contracting authorities are very likely to waive the restrictions for fuel, computers, medical equipment and pharmaceuticals, probably the *real* impact will amount to only to 2 billion EUR will be impacted (because the assumed rejection rate is 50%). Also, non-GPA/FTA countries will be severely impacted by the restrictions, and imports may be shifted from them to GPA/FTA countries (e.g. computers from China would be replaced by Taiwanese computers).

-Supply chains: We estimate the impact on supply chains to be between 0.3-0.4 billion EUR with China and US (cf. Annex 4, pp.25)

-Potential retaliations by third countries could impact up to some 1 billion EUR of EU exports of goods and services (some 150,000 jobs).

8.4. Leverage: Leverage increases for all countries, in particular with Brazil, but less so vis-à-vis the US because of the large trade in pharmaceuticals.

Table VIII.1 - Leverage

	Option 4 Leverage index	Baseline Leverage index
USA	11%	0%
Japan	27%	0%
Canada	21%	0%
Korea	56%	0%
Mexico	0%	0%
Israel	0%	0%
China	19%	0%
Russia	51%	0%
India	28%	0%
Brazil	91%	0%
Turkey	26%	0%
Australia	27%	0%

Sources: WTO, DG MARKT, Eurostat, own calculations

8.5. Public finances The overall impact on public finances is negligible (less than in option 3A).

8.6. Administrative burden: The administrative burden is expected to amount 3,5 million EUR, (production of certificate of origin for businesses) increasing therefore the total administrative burden of public procurement by 1,7 % and would not affect the total cost of public procurement procedures²⁷.

8.7 Impact on competition and innovation: Effects on competition depend on the type of good and service (overall there are 5 bids per tender in the EU). Still, those areas where competition is weakest (pharmaceuticals), contracting authorities will be able to not use notifications. Similar effects to those of option 2 can be expected in railways and energy.

8.8 Impact on consumers - minimal

8.9 Environmental impact - cf. option 3A

²⁷ cf PWC study that estimates the cost of PP procedures to 5 billion euros.

9. Option 5: 'Buy Europe'

To level the playing field with main partners like US and China, the EU could create a system of price preferences with a 25% margin to mirror the Buy American and Buy China for non-covered procurement. This system would require a strict monitoring by the Commission to avoid breaches of international commitments.

However, by doing so, the EU would give precisely credibility to the price preference mechanisms across the world against which it is fighting. US or China would have then no incentives to remove these barriers that lead to inefficient business decisions (artificial competitiveness and jobs). In the long-term, this initiative could actually weaken certain EU industries. As a result, this option will uselessly create administrative burdens while stimulating protectionism within the EU. This option should be discarded from the outset and shall not be analysed.

10. Option 6: correcting unfair 'abnormally low tenders' (complementary option)

The options outlined before could also be complemented by an option that would aim aimed remedying the problem of certain third countries' suppliers that can offer (very) low prices since they receive subsidies or benefit of other unfair competition practices through the existing rules on abnormally low bids as provided for in the public procurement directives could be strengthened to improve the level playing field.

The current rules on abnormally low tenders (Articles 57 of Directive 2004/17/EC and Article 58 of Directive 2004/18/EC) give contracting entities the option to exclude tenders, amongst others if this operator has illegally received state-aid, after a enquiring in writings about the elements likely to explain the price gap.

This procedure presents some certain weaknesses. The decision on what is an abnormally low tender is left to the discretion of contracting entities²⁸. In addition, the investigation on the elements justifying the price gap is mandatory only when the entity intends to reject the abnormally tenders. Finally other tenderers are not informed that the entity has accepted abnormally tenders.

A more stringent set of rules could encourage the use of this mechanism, with a view to ensure fair competition and avoiding problems with the execution of contracts based on unrealistic low bids.

Entities would preserve discretion to admit abnormally low bids. However, the following improvements could be introduced:

- The rules would apply to tenders made up for more than 50% of non-covered goods and/or services
- The contracting entity has to ask the tenderer the details of the constituent elements of the tender (including the existence of state-aid, the application of social and environmental standards) in case the price or costs are at least 20% lower than the second lowest tender;
- If the contracting entity intends, after verification of the constituent elements of the tender and taking into account the evidence supplied, to accept the tender it shall inform the other tenderers of this in writing, including the reasons for the low character of the price/costs.

Analysis of impacts:

The number of procedures involving abnormally low tenders has not yet been measured, but there is no evidence of widespread practices. As a result, the probability of associating an abnormally low tender with a tender foreign goods and services is not very high.

²⁸ Except for Portugal, none of the Member States provides for a clarification of the range of what is an abnormally low tender.

On the other hand, the awarding of abnormally low contract to a Chinese construction company in the field of construction has caused much debate on the concept of reciprocity.

If the average saving in procurement procedures amounts to 5%, the threshold for abnormally low tender further to the aforementioned reference to 20%, will ultimately be 25%.